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Re-Evaluating Poverty Alleviation Strategies: The Impact of Microfinance on Child Labor in Bangladesh.

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CLAREMONT McKENNA COLLEGE

**RE-EVALUATING POVERTY ALLEVIATION STRATEGIES:
THE IMPACT OF MICROFINANCE ON CHILD LABOR IN BANGLADESH**

SUBMITTED TO

RODERIC CAMP

AND

DEAN GREGORY HESS

BY

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FOR

HONORS SENIOR THESIS IN INTERNATIONAL RELATIONS

2007-2008

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List of Abbreviations

ASCA Accumulating Savings and Credit Associations
BBS Bangladesh Bureau of Statistics
BRAC Bangladesh Rural Advancement Committee
BRDB Bangladesh Rural Development Board
CDF Credit and Development Forum
CGAP Consultative Group to Assist the Poorest (part of the World Bank)
CRC United Nations Convention on the Rights of the Child
GDP Gross Domestic Product
GDRC Global Development Research Center
ILO International Labor Organization
IPEC International Program on the Elimination of Child Labor
MFI Microfinance Institution
MICS Bangladesh Multiple Indicator Cluster Survey
NGO Non-governmental Organization
ODA Official Development Assistance
ROSCA Rotating Credit and Savings Association
SCUK Save the Children UK
SIMPOC Statistical Information and Monitoring Program on Child Labor
UN United Nations
UNCDF United Nations Capital Development Fund
UNDP United Nations Development Program
UNESCO United Nations Educational, Scientific and Cultural Organization
UNICEF United Nations Children's Fund
WWB Women's World Banking Network

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Abstract

Microfinance has become one of the most promising tools for development and poverty alleviation over the past two decades. Millions of borrowers around the globe have utilized microcredit to start or expand their small businesses and raise their household income. One poverty-induced problem microfinance could potentially alleviate is child labor. Despite international legislation prohibiting it, child labor continues to deprive millions of children of their right to education. Without education, there is little hope for a country to increase productivity and wealth in the future. A number of scholars have highlighted a negative correlation between credit rationing and child labor. However, there are no studies that examine whether or not children are less likely to work in households that participate in microfinance programs. In some circumstances, microcredit may increase household income and induce parents to withdraw their children from work while in others, raising the household income level may lead children to work more. In low-income countries with numerous microfinance institutions, many children work despite their parents' access to credit. In order to examine this paradoxical phenomenon, this thesis presents a number of econometric models which analyze both child labor and credit at the household level. Though these models are vital in explaining the relevant trends, a purely economic analysis fails to capture the political and cultural factors that also engender child labor. To illustrate this complex relationship between economics and mores, this thesis highlights the impact of microfinance on child labor in Bangladesh. Bangladesh is an ideal country for this study because microfinance and child labor are both endemic. Finally, conclusions drawn from this analysis inform policy recommendations to amplify the effectiveness of microfinance on diminishing child labor

Introduction

Halima is 12 years old and works at a processing plant in Khulna, Bangladesh de-heading, shelling and packing shrimp for 10 hours a day. She receives 43 takas for her labor (US \$0.62) and has been working since she was 5 years old because, in her own words, she has “no other choice.” Her mother is a messenger at a nearby school and her father is a day laborer who is currently unemployed. Halima dreams of pursuing an education so that she can become a social worker and help other poor children because she feels that she can represent them. After work, Halima goes to an informal school for two hours where she learns to read and write. Halima has never attended formal school because her family has never been able to survive without her income. There are millions of children just like Halima around the world who are denied their basic human rights to an education and well-being by having to work. If Halima’s parents had access to credit, they may be able to send her to school, however, this is not necessarily the case.

In order to assess the hypothesis that microfinance can have ambiguous effects on child labor in Bangladesh, the first two chapters address both topics at the theoretical and global levels. Chapter one begins by distinguishing between the “promotional” and “protectional” approaches to microfinance. “Promotional” microfinance initiatives seek to alleviate poverty in the long run through self-employment and therefore exclude the poorest, while the objective of “protectional” programs is to mitigate fluctuations in income and fulfill the basic needs of the poorest in the short term (Hulme and Mosley 1997, 100). The following section explains that the poor lack access to credit and financial services provided by mainstream commercial banks because they lack

collateral, identification, savings for registration and initial fees and financial education. The exclusion of the poor from the formal economy not only renders them socioeconomically invisible, but also prevents them from consuming beyond their immediate means and investing in their business or the education of their children in order to escape poverty.

Microfinance enables families to expend more than they earn, but in order to maximize its effectiveness, microfinance institutions (MFIs) must focus on a particular group of the poor and design a program that provides financial and social services that suit their needs. Because the poor demand different services depending on their gender, income level and geographical location, there are several types of financial service providers. Informal providers include friends or relatives, moneylenders, deposit collectors, pawnbrokers and credit and savings associations known as ROSCAs and ASCAs. Non-governmental organizations (NGOs) comprise their own category and usually buttress microfinance with other health, education and social programs. In contrast, there are formal financial institutions involved in microfinance including specialized microfinance and mainstream commercial banks whose economies of scale lower their transaction costs which enables them to offer more services to the poor at a lower price. Unfortunately, large-scale commercial banks still lack the incentive to lend to poor clients who lack collateral and pose a high risk of default. Contrary to popular belief, however, microfinance can be profitable, for the world's top MFIs had average rates of return that rival those of mainstream commercial banks.

The central governments of low-income countries often adopt microfinance as one facet of their developmental strategy and can facilitate its success by achieving some

degree of macroeconomic stability, improving financial infrastructure and establishing a regulatory framework for the provision of financial services to the poor. Microfinance is ubiquitous throughout the Third World because numerous studies demonstrate that microfinance can reduce the vulnerability of the poor in times of crisis by raising household income. Despite all of the praise it garners, scholars generally agree that microfinance is not the appropriate tool to combat all degrees of poverty because the most destitute citizens must meet their basic needs first. Others argue that the current emphasis on microfinance in the development field diverts attention and Official Development Assistance (ODA) from more vital programs and even that microcredit can entrench poor borrowers further into debt.

Chapter two informs the reader about child labor on the macro and microeconomic levels. Children who work are classified as either being “economically active”, engaged in “child labor” or engaged in “hazardous work”. In the international political realm, “child labor” is the most widely employed category and accounts for approximately 166 million children worldwide. Scholars and organizations such as the United Nations Children’s Fund (UNICEF) have criticized statistics collected by the International Labor Organization (ILO) for their failure to adequately capture the extent to which children, especially girls, contribute to household income. Globally, agriculture is the primary activity of working children and boys are much more likely to work than girls. Interestingly enough, most child laborers work in their own household rather than participating in the wage labor market. Though the dominance of domestic labor diminishes the likelihood that children will be engaged in activities that threaten their safety and well-being, most forms of child labor impede the ability of children to receive

an adequate education. In spite of international accords created by the ILO and the United Nations (UN) to establish minimum age standards and protect the rights of children, child labor continues to plague much of the world.

Poverty is the primary determinant of child labor, but cultural and social factors also play a role. Statistics indicate that there is a strong, negative correlation between GDP and the incidence of child labor worldwide, however, what is more pertinent to this thesis is that poverty and child labor are positively correlated at the household level (Schultz 1960; Basu and Van 1998). Economists posit that in extremely poor households, work and school are substitutes for children which keeps them caught in the so-called “child labor trap” (Basu and Van 1998; Wahba 2002; Emerson and Souza 2003; Baland and Robinson 2000). Conversely, there are a number of economic studies that do not find a significant correlation between household income and child labor, but that instead attribute child labor to a host of factors including culture, infrastructural development and the availability of viable alternatives (Ray 2000; Edmonds and Pavcnik 2005; Bhatta 1998).

One key observation is the counterintuitive observation that increases in household income can actually increase child labor, a phenomenon known as the “wealth paradox”, an idea that is very important in the context of Bangladesh (Rogers and Swinnerton 2003; Edmonds and Turk 2004; Kanbargi and Kulkarni 1991; Basu and Tzannatos 2003). In its final portion, this chapter seeks to emphasize the positive relationship demonstrated by scholars between credit constraints and child labor that enables policymakers to see the inherent potential of microfinance programs to diminish

child labor (Jacoby and Skoufias 1997; Beegle, Dehejia, and Gatti 2002; Ranjan 1999, 2001; Guarcello, et. al 2002).

Chapter three is the crux of this thesis and focuses specifically on the relationship between microfinance and child labor in Bangladesh. As a result of its extremely dense population, low-productivity economy and acute vulnerability to natural disasters, approximately 80 percent of Bangladeshis live on less than US \$2 per day. Consequently, the majority of the population operates in the informal market where they are excluded from formal financial services. The central government of Bangladesh is also highly decentralized, elitist, corrupt and ineffective in enforcing legislation. This environment incited economics Professor Muhammad Yunus to launch an unprecedented experiment to lend his own money to poor, rural women to start their own small businesses. After thirty years of successfully lending to poor women, Grameen Bank is the most recognized and imitated microfinance institution in the world. Today the microfinance industry serves about 25 million clients most of whom participate in BRAC, Grameen Bank, ASA and Proshika programs (Credit and Development Forum 2006). The majority of MFIs in Bangladesh target rural women who own less than half an acre of land and offer small-scale, collateral-free loans and savings accounts so that they can start or expand their small business or cope with economic shocks and crises.

Many of the same factors that have led to the pervasiveness of microfinance in Bangladesh also incite children to work. Almost 13 percent of Bangladeshi children are engaged in child labor and the majority of child laborers do not attend school at all (MICS 2006, 101). Though most children work domestically and are less apt to be engaged in hazardous work they are still impeded from attending school. Child labor not

only infringes on the rights of individual children to receive an education and enjoy time for leisure today, but also prevents the development of a skilled workforce that will lead to economic growth in the future. Data from Bangladesh supports global trends delineating poverty as the most salient factor in determining the likelihood that children will work (Delap 2001; Salmon 2005; Amin, Quays, Rives 2004; Save the Children UK; ILO 2006). Scholars have demonstrated that microfinance can raise household income levels in Bangladesh (Pitt and Khandker 1998) thus, in theory microfinance diminishes child labor, however, in reality it may produce ambiguous results. In one scenario, borrowers enjoy greater household incomes but economic gains may not be sufficient enough to enable parents to afford to withdraw their children from work. Economic status is also not the only factor that contributes to the high prevalence of child labor in Bangladesh as limited educational opportunities, gender discrimination, cultural perceptions of childhood and the demographic structure of the Bangladeshi labor market also play an important role. Natural disasters and seasonality in agriculture and employment render poor Bangladeshi households extremely vulnerable to negative economic shocks. Crises generally incite children to work, but access to credit has been shown to stabilize household income in Bangladesh (Morduch 1998; Pitt and Khandker 1998; Khandker 1998) therefore it is possible that microfinance can decrease child labor by smoothing household income. Finally, it is theoretically possible that microfinance can actually increase child labor in a phenomenon known as the “Wealth Paradox”. If women pursue self-employment as a result of microcredit they may utilize their children as free, convenient labor to work in the family business. In this instance, girls are much more likely to suffer because they absorb household chores which Bangladeshi society

upholds to be exclusively female tasks. It is important to note that the majority of children whose parents participate in microfinance programs enjoy better food, clothing and housing. Field observations suggest that there are children who are negatively affected by their household's participation in microfinance programs, although the incidence and extent of this phenomenon is unknown and warrants a more rigorous, quantitative assessment.

The final chapter provides policy recommendations for improving the effectiveness of microfinance in Bangladesh in diminishing child labor. One suggestion is for MFIs to collaborate with children's advocacy groups and target the parents of working children as borrowers. Another idea is to provide working children with the opportunity to save their earnings or, in some circumstances, even borrow small amounts to start their own businesses. Policymakers and scholars may never have intended for microfinance to be a vehicle for decreasing the incidence of child labor, but it certainly has the potential to do so.

Chapter 1: Microfinance – Approaches, Structures and Global Trends

Contrary to popular belief, microfinance is not new a new phenomenon. Since the beginning of commercial activity, the concept of microfinance has manifest itself in a variety of forms from credit cooperatives to local moneylenders to large-scale “Banks for the Poor” scattered throughout the world today. Since the inception of its modern form in the late 1970s in Latin America and Asia, microfinance has enabled millions of the world’s poor to access credit and financial services. Since the official year of the Microcredit and the Microcredit Summit Campaign in 1997, microcredit has grown an astonishing 978 percent (Daley-Harris 2006, 19). Criticized by many international actors for its over usage and generality, the term microfinance refers to a wide range of financial services including collateral-free, small-scale home, enterprise, and education loans; savings, insurance, and pension schemes. Without access to credit and financial services, poor households cannot consume beyond their meager income levels, save in order to cushion themselves against exogenous, negative income shocks or, in extreme cases, even afford to send their children to school. Eighty percent of the world’s poor lack access to credit and less than 2 percent has access to financial services (credit, deposit, or savings) from sources other than unregulated moneylenders that charge rates far exceeding those established by the market. Hence microfinance fills an important niche by enabling poor households to access the credit, capital and savings required to improve their economic and physical welfare.

Main Approaches

Although the range of financial services a microfinance institution (MFI) offers depends on the specific needs of its target clientele, two ideological and structural approaches dominate the industry. In the “promotional” strategy, organizations supply the poor with credit in order to generate self-employment and increase household income in the long run (Wood and Sharif 1997, 100). Within this framework, MFIs have different goals depending on the relative wealth of their borrowers. In lending to microentrepreneurs with larger and more profitable businesses, MFIs aim to achieve long-run growth throughout society and offer larger loans which enable borrowers to expand their businesses and create jobs for even poorer people. Most MFIs do not follow this “trickle-down” approach because it excludes the majority of the poor. As a result, many MFIs have adopted with a “protectional” approach target poorer clients with the objective of alleviating more immediate symptoms of poverty and enabling households to cope with income volatility through small-scale credit and savings programs (Wood and Sharif 1997, 100). In this model, microfinance acts “as a first step to helping people escape poverty in the long term,” and over time clients can graduate to larger loan amounts (Dunford 1998, 6). Regardless of the institutional aims of various organizations and their particular clientele, microfinance provides the poor with access to financial services from which they are otherwise excluded.

Why the Poor Lack Access to Credit

The crux of microfinance is to enable the poor to borrow and accumulate enough capital and savings to escape the inexorable cycle of poverty. Ideally, borrowers will eventually cease to rely on microfinance, become self-sufficient and graduate into participating in the formal economy. The majority of the world’s poor is limited to

operating in the informal economy and cannot access financial services from commercial banks because they lack collateral, identification, savings for registration and initial fees and financial education. These factors combined with geographical isolation of the rural population cause commercial banks to view the provision of financial services to the poor as a risky and unprofitable business. According to the World Bank, the inability of the poor to access credit and other banking services arises from “institutional failures that make contract enforcement difficult and do not address the problems of informational asymmetries and the poor’s lack of collateralizable wealth” (Perry 2006, 15). Simply stated, the traditional structure of commercial banking institutions is innately incompatible with the needs of the poor who lack documentation of their property, collateral and knowledge about finances. Because “effective participation in financial markets is a precondition for effective participation in the economy,” the exclusion of the world’s poorest citizens from accessing formal financial services and markets translates into socioeconomic exclusion and invisibility (Kumar 2005, 15). Without the capacity to borrow and consume beyond their low incomes, poor households cannot invest in items with long-run returns such as household improvements, small businesses or even the education of their children thereby perpetuating the intergenerational transmission of poverty.

Financial Service Providers

It is clear that integrating the poor into the formal economy in the long run requires that they have access to financial services. Poor clients demand different services

than those offered by conventional banks and their needs vary depending on their income level, geographic location and community. As a result, there are several types of financial service providers ranging from informal moneylenders and credit cooperatives at the village level to large-scale commercial banks. Today approximately one-third of poor clients gain access financial services through microfinance NGOs, one-third through mainstream financial institutions and one-third through cooperatives and credit unions (Women's World Banking 2003). Each approach has its respective strengths and weaknesses which must be analyzed within the context of the needs of its target clientele. Individual informal service providers include a friend or relative, local moneylenders, deposit collectors (i.e. people who collect and store savings) pawnbrokers, and, in agricultural areas, traders, processors and input suppliers (Helms 2006, 37-38). Borrowing from a friend or relative can be awkward, embarrassing and potentially detrimental to a personal relationship. Local moneylenders and pawnbrokers are notorious for exploiting poor borrowers by charging them exorbitant interest rates while in many places deposit collectors may not be reliable. Rotating credit and savings associations (ROSCAs) and accumulating savings and credit associations (ASCAs) are the most effective informal financial service providers behind NGOs because borrowers are responsible for their ownership and management. In both formations, group members donate to a self-managed, collective fund. In ROSCAs, contributors receive either a portion of or the entire "pot" in rotation or by lottery and the fund is liquidated with every cycle (Helms 2006, 39). In ASCAs, however, some contributors borrow and some do not, therefore the fund increases with time (Helms 2006, 39). ROSCAs and ASCAs are extremely popular throughout the world today because "they are efficient and cost little

to run, they are transparent and easy for members to understand, no outsiders are involved, no cash is stored since it passes from member to member, and the risks of misappropriation are low” (Helms 2006, 39). Though ASCAs generally offer more services, they require a higher level of managerial skills and run the risk of fraud because the money does not rotate evenly throughout the group (Helms 2006, 39).

Financial service associations, self-help groups and cooperatives comprise another category of informal service providers that are owned and controlled by their members. These groups are formed at the local level and usually provide a broader range of financial services including savings, checking accounts, loans, insurance and transfer services. One of the advantages of these schemes is that group members are shareholders and, as a result, receive dividends, higher interest rates on savings accounts, lower loan rates, and innovative and superior services than those who borrow from exogenous institutions (Helms 2006, 42-43). One of the primary disadvantages of endogenous financial associations is that they are voluntarily managed and their members often lack the requisite skills to run such an organization. Another drawback is that financial regulators rarely oversee or monitor their operations which diminishes external pressure to increase efficiency and transparency, and leaves members’ funds vulnerable to internal conflict and corruption (Helms 2006, 44). Though all of these informal service providers enable the poor to borrow and save, they can be expensive, rigid, risky, opaque, corrupt, deceitful and vulnerable to collective external shocks such as illness, natural disasters and crop failure (Helms 2006, 40).

Unlike these informal providers and groups, NGOs are usually formed at the regional or national level and establish branches in vulnerable neighborhoods and

villages. NGOs inhabit their own category and usually have a more holistic and altruistic approach to providing financial services. Some NGOs serve as the intermediary between small-business owners and formal banks, thereby enabling them to access credit, while others couple financial services with social and development programs such as entrepreneurial, health, and family planning education (Helms 2006, 44). The CGAP estimates that there are 9,000 NGOs worldwide that provide the poor with access to financial services (Helms 2006, 45). Unfortunately, NGOs are often limited in their capacity to offer a wide range of flexible financial services due to donor constraints. Most NGOs aim to become formal, sustainable financial institutions in order to serve more poor clients and expand the range of non-credit interventions they offer such as skills and vocational training, informal primary education, etc. In certain circumstances, the push for commercialization can hinder the institutional effectiveness of NGOs and even hurt the well-being of borrowers. The most successful transition from NGO to commercial institution is the Grameen Bank, which, with the passage of a special law created only for it, legally became a poverty-oriented development bank in 1983.

Formal financial institutions that provide services to the poor range from commercial banks that create social programs based on government incentives to specialized microfinance banks such as the Grameen Bank. As previously mentioned, the majority of microfinance clients still access financial services through government-owned development, agricultural, savings and postal banks – it is often the only option available to the rural poor outside of their village moneylender (Helms 2006, 49). Small community or rural banks, specialized microfinance banks, and full-service banks that offer microfinance also fall into this category. According to CGAP, there are only 225

commercial financial institutions involved in microfinance in some way, however, participating commercial banks are more cost-efficient in delivering financial services to the poor (Helms 2006, 49).

Though few currently offer financial services exclusively tailored to the poor, large private banks do in fact have their niche in microfinance. Both private and state-owned commercial banks have the advantage of economies of scale in lowering their transaction costs, but considering their objective is economic profit and not poverty reduction, the high per-unit expenses are eclipsed by the low returns received on microloans. For example, commercial banks can charge lending rates as low as 14 percent while MFIs are forced to charge 31 percent (Unitus 2006). According to the Women's World Banking Network, "Most mainstream financial institutions still do not see the poor as a major untapped market of bankable customers," because they are generally a high-risk, geographically isolated, and uneducated segment of the population who cannot generate the same level of profits for the bank as their wealthier counterparts (WWB 2003). If banks are going to enter into the microfinance market, they should utilize their capital and management structures to establish subsidiary institutions, build new microfinance and/or rural branches, and research and develop innovative services for the poor. Commercial banks have a competitive advantage over financial service providers because they are part of a well-developed financial network which enables them to access financing from donors and other institutions more easily. The hope is that as MFIs accrue more capital and become commercial institutions, conventional banks will see their success and will be enticed to enter the microfinance market. The entry of large-scale commercial banks into the microfinance market will increase competition and

lead to the provision of a greater variety of services for poor clients at a lower cost. This process may be years away, however, for commercial banks still lack the economic incentive to offer credit and savings to the poor because of the inherent risk in lending to them.

Contrary to popular belief, providing financial services to the poor is not merely a charitable endeavour. In fact, after adjusting for inflation and subsidies programs received, 63 of the world's top MFIs had an average rate of return of about 2.5 percent of total assets which is comparable to returns from commercial banking (Microfinance Gateway 2006). The key to achieving long-term sustainability success are high repayment and cost-recovery rates that allow "Banks for the Poor" to cover their transactions costs and provide financial services to a large client base at a lower cost. Moreover, there is no evidence that MFIs absolutely cannot serve the poorest while being profitable. On the contrary, research shows that sustainable MFIs that provide services to the very poor reach one and a half times more clients on average which implies that they are far more efficient while using fewer resources (Daley-Harris 2006, 21). In Bangladesh, ASA, meaning "hope" in Bengali, reaches more than 2.7 million clients, many of whom are very poor, and lends at a rate of US \$0.35 cents per dollar earning it the illustrious title of "the most efficient MFI in the world" (Daley-Harris 2006, 21). As it stands today, however, the majority of MFIs do not share ASA's economic efficiency and low transaction costs.

Figure 1.1: Pros and Cons of Different Financial Service Providers

Service Provider	Examples	Strengths	Weaknesses
Informal	Moneylenders ROSCAs ASCAs Input suppliers	<ul style="list-style-type: none"> • convenient and fast • close to clients • low-cost operations (ROSCAs and ASCAs) • accessible to poor and remote 	<ul style="list-style-type: none"> • some are insecure and unstable • limited scope of operations • rigid (clubs) • expensive (moneylenders)
Member-owned	SHGs FSAs CVECAs Financial cooperatives	<ul style="list-style-type: none"> • indigenous • low-cost operations • accessible to poor and remote • profits used to benefit members 	<ul style="list-style-type: none"> • governance challenges (risk of capture by net borrowers, manager-dominated) • in many countries, lack of effective financial supervision • scope of operations limited to members • limited products offered
NGOs	International network affiliates Domestic NGOs	<ul style="list-style-type: none"> • knowledge of poor clients • social mission-driven • more willing and able to take risks to work at frontier 	<ul style="list-style-type: none"> • many donor dependent • limited range of services: limited or no voluntary savings • small scale (except South Asia) • high-cost operations in many cases (with major exceptions)
Formal Financial Institutions	Government-owned banks Rural or community banks NBFIs Mainstream commercial banks	<ul style="list-style-type: none"> • broad range of services • large branch infrastructure and points of sale • own capital • resources to invest in technology and innovation 	<ul style="list-style-type: none"> • profit motive may dilute social mission • difficult to reach very poor and remote clients • products often do not always meet the needs of the poor
<p>Note: ROSCAs = rotating savings and credit associations; ASCAs = accumulating savings and credit associations; CVECAs = Caisses Villageoises d'Épargne et de Crédit Autogérées; FSAs = financial service associations; SHGs = self-help groups; NGOs = nongovernmental organization; NBFIs = nonbank financial institutions.</p>			

Source: Helms 2006, 56.

Transaction Costs and Interest Rates

MFIs have much higher transaction costs than their commercial counterparts as a result of the unique nature of lending to the poor. Microfinance clients lack collateral and

operate in the informal economy which means that they lack credit histories, financial records and legal proof of ownership of their assets. As a result, poor borrowers can only receive an unsecured loan, or one without collateral, which poses a greater risk to lenders. One way that MFIs have mitigated the risk of lending to the poor is to adapt a group-lending model which utilizes peer pressure, reputation and honor, or “social collateral”, to hold individuals responsible for repayment. Still, MFIs must assess the creditworthiness of borrowers on the ground which requires a lot of manpower. In fact, lending risks are so high that transaction costs may constitute 25 percent of the value of the loan (Microfinance Gateway 2006). As experts at the Microfinance Gateway, a website that provides comprehensive information on the microfinance industry, explain:

A \$100 dollar loan, for example, requires the same personnel and resources as a \$2,000 one...[because] loan officers must visit the client's home or place of work, evaluate [their] creditworthiness on the basis of interviews with the client's family and references, and in many cases, follow through with visits to reinforce the repayment culture (Microfinance Gateway 2006).

These high credit assessment costs, along with the small loan size and long repayment period that characterize microloans, force MFIs to charge above-market interest rates to their clients. Though this seems counterintuitive in terms of decreasing household poverty, research shows that subsidized interest rates create excess demand that leads to even higher transaction costs that undermine the impact of the subsidy (Microfinance Gateway 2006). Moreover, clients have demonstrated their willingness to pay higher interest rates in order to ensure their continuing access to credit in the future. Ultimately, MFIs aim to become regulated financial institutions in order to attract more private capital, increase their operational efficiency and lower their transaction costs such that they can charge lower interest rates and provide financial services to more of the world's

poor. The government and financial regulators play a key role in facilitating the formal institutionalization of microfinance.

The Role of Government and Financial Regulators

Without the government's ideological and legislative support, low-income countries cannot successfully implement and maintain microfinance programs as part of their strategy to reduce poverty and increase economic growth. Macroeconomic policies and financial regulations can greatly hinder or enable the success of the microfinance industry in a given country. Though it is tempting and relatively easier to for governments to provide credit directly to their citizens, the Women's World Banking Network asserts that, "government programs – normally based on a social welfare, subsidy approach - nearly always end in being used as vehicles for political patronage, extremely low repayments, market distortions, and eventual truncation of services" (WWB 2002, 8). Over the past twenty years, the majority of government microfinance initiatives have generally failed because they lack adequate client targeting and inconsistently punish defaulters (CGAP 2007). In instances where the government has successfully participated in microfinance schemes, the state has funded independent MFIs such as the Grameen Bank. Ideally, public banks should not be microfinance "retailers," though if they autonomously select clients, provide unsubsidized lending rates and separate microfinance operations from their other financial services it is possible for governments to effectively disburse microfinance to the poor (WWB 2002).

Even if the government does not act directly provide credit to its poor population, it does play an essential role in facilitating and regulating the microfinance industry by enacting both pro-poor and pro-growth policies. In addition to establishing a regulatory

organ and promoting microfinance as part of its pro-poor strategy, low-income countries should also aim to stabilize their economy and avoid high inflation. Macroeconomic development is required to provide the government with adequate funding to monitor and regulate the microfinance industry and ensure its sustainability and effectiveness in the future. As the United Nations Capital Development Fund (UNCDF) explains, “It is only through the development of the financial sector as a whole that sustainability of financial services for the lower segments in the market can be ensured and sustainable access to financial services by poor and low-income people guaranteed” (UNCDF 2003). Some of the most critical duties of a government seeking to expand microfinance include eliminating legislative barriers impeding MFIs from becoming regulated financial institutions and allowing competition to determine interest rates as opposed to subsidizing them. When governments eliminate interest rate ceilings they may increase market efficiency and lower interest rates over time, but doing so may mean that microfinance institutions can no longer cover their transaction costs which exceed those imposed by mainstream commercial banks (CGAP 2007).

Governments should also implement legal standards for performance indicators which encourage transparency by establishing credit bureaus and rating and audit agencies to monitor the progress of the microfinance industry, maintain its integrity and facilitate the integration of MFIs “into the formal financial system” (van Gruening 1998, 2). Though it is essential that licensing and reporting requirements remain strict, financial regulators should simplify their procedures and documentation to provide incentive for MFIs to comply. Moreover, the government must refrain from excessively intervening in internal structure of MFIs that need the “freedom to operate” and the ability to

autonomously decide on their branch structure, management and ownership (i.e. private local and foreign investors, NGOs, etc.) (van Gruening 1998, 2). Finally, federal laws that prohibit the disclosure of citizens' financial history (in the absence of a credit report, this consists of utility bills, paychecks, etc.) should be eased so that MFIs can better assess the inherent risk of lending to a particular client.

In order to facilitate the transition of MFIs to becoming regulated financial institutions, federal financial regulators should reduce minimum capital requirements and government officials should enact reforms to make taxes less regressive and biased in favor of large, private banks by providing "temporary tax incentives for microfinance institutions undertaking the costs of converting to formal, regulated structures" (van Gruening 1998, 2). Financial regulators should also encourage commercial banks to provide microcredit by easing restrictions on the percentage of a loan portfolio that can be lent on an unsecured basis (van Gruening 1998, 2). Limits on the establishment of new branches and their locations or form must also be removed and, in many countries, an alternative definition of "branch" must be adopted so that MFIs can offer a variety of financial services in both rural and urban areas (CGAP 2007). Unfortunately, if a government lacks the substantive power to enforce these legislative changes it will not be able to create a thriving and regulated microfinance industry. Even in the absence of government support, however, MFIs can effectively provide financial services to the poor and mitigate the symptoms of poverty.

Statistics

MFIs operate in a wide array of political and cultural contexts and have become ubiquitous throughout the Third World. The Consultative Group to Assist the Poorest

(CGAP), an organization of the world's largest aid donors, functions as both an ideological and policy-orientated arm of global agencies dedicated to promoting, improving and expanding microfinance worldwide. According to their latest statistics, MFIs have amassed over US \$750 million in collective savings from approximately 500 million active clients (Helms 2006, 6). According to the *Microcredit Summit Campaign Report*, in 2006 over 3,000 microcredit institutions reached approximately 113,251,390 clients, approximately 82 million of whom fell in the bottom half of those living below their country's poverty line or below US \$1 a day (Daley-Harris 2006, 18). Microfinance remains extremely concentrated in Asia, which accounts for 84 percent of all participants (Helms 2006, 20), as a result of the fact that 67 percent of people in the world who subsist on less than US \$1 a day live in the region (Daley-Harris 2006, 18).

Although these statistics seem impressive, participation rates represent a mere fraction of the over 3 billion people in the world who live below the official global poverty line of US \$2 per day. Of the billions of impoverished people who lack access to credit, 500-600 million are eligible for microcredit that may enable them to improve the welfare of their families (PlaNet Finance 2006). The challenge for aid organizations, governments, and microfinance institutions is to augment the geographic and economic penetration, effectiveness and sustainability of microfinance with the hopes of eventually incorporating the poor, extralegal sector into the formal economy and creating lasting change.

Global Impact Assessment

Microfinance is only one facet of a country's complex poverty-reduction and growth strategy that requires myriad legal, political and economic reforms, however, that

does not diminish its impact on the household level. Studies demonstrate the significant, positive impact of microfinance in raising household income levels and (Robinson 2001; Remenyi and Quinones 2000; Wright 2000; UNICEF 1997; Khandker 1998, 2001) reducing vulnerability to adverse income shocks (Wright 2000; Zaman 2000; McCulloch and Baulch 2000). In a study of over 24 countries, the NGO Unitus found that borrowers' profits increased 25 to 40 percent as a result of their ability to purchase more raw materials and supplies (UNCDF 2003). These increases in income enable clients to spend more on health care, medicine, and education. Studies in Kenya, Honduras, (Ardon and Colindres 1997) Bolivia, (McNelly and Dunford 1999) Pakistan and Ghana (Bhalotra and Heady 2003) demonstrate that improved access to credit increases the school attendance rates and nutritional status of borrowers' children. Savings has a smaller economic impact than credit, for it has not been shown to generate income, but it may be important in mitigating adverse income shocks and thereby enabling children to attend school or household members to seek medical attention and take time off work (Morduch and Haley 2002).

Female empowerment is another of the most important positive impacts of microfinance on participants. Around the world millions of poor women have gained economic and social clout both inside and outside of the household. For the fact that female microfinance clients in Bangladesh, Bolivia, Nepal, the Philippines, and Russia have all been elected into public office manifests its true potential to empower poor women around the world (Helms 2006, 31). These are merely a few examples of the potential of MFIs to change the status quo of the billions of people who continue to live in extreme poverty. As a testament to its efficacy, the United Nations endorsed

microcredit as “an effective tool for increasing productive capacities of local communities, the inclusion of poor people in economic flows, promoting local markets growth, creating jobs and employment opportunities” (Chowdhury 2004, 1). Today microfinance is one of the most popular and effective approaches to alleviating poverty at the grassroots level, though it is not without weaknesses.

Criticisms

Despite the significance of these findings, critics argue that microfinance is not the universal prescription for development that many proclaim it to be. As previously mentioned, subsidy-dependent government programs distort market prices and negatively impact borrowers in the long run as interest payments exceed any accrued benefit from a subsidy. According to 2001 World Bank statistics, the top five MFIs reach almost half of the market and that only 1 percent of MFIs are financially stable which indicates the difficulties of achieving self-sufficiency in serving such a high-risk clientele (Unitus 2006). Even though “many feel that once microfinance becomes mainstreamed, massive growth in the numbers of clients can be achieved...others worry that an excessive concern about profit in microfinance will lead MFIs up-market, to serve better off clients who can absorb larger loan amounts” (Microfinance Gateway 2006). This “crowding out” of private investment undermines MFIs’ purpose of societal development and equity by excluding the very population it sought to assist.

Microfinance does not always suit the needs of the poor. The Consultative Group to Assist the Poorest (CGAP), an auxiliary of the World Bank, explains that extremely poor people whose lack of income prevents them from fulfilling their basic needs are not candidates for microfinance; in this instance, the CGAP suggests that “other tools will

alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements...[which], where possible...should be coupled with building savings” (CGAP 2007). Development expert Marguerite Robinson espouses this view and argues that instead of credit or savings accounts for extremely poor households organizations should provide them with job creation, skills training, relocation, and adequate water, medicine, and nutrition. She continues, “Providing savings accounts and credit makes sense only for the ‘economically active’ poor [but] *only* (not the emphasis of the original author) savings is right for the poorest among this economically active population” (Daley-Harris 2006, 15). The most destitute of citizens often exclude themselves from microfinance schemes because they perceive themselves to be ineligible due to a lack of identification, liquid assets and savings, and financial education. Nevertheless, less than two-thirds of microfinance clients live below the extreme poverty line of US \$1 per day though this trend is improving as MFIs seek to expand the range of clients and services offered (Helms 2006, 20).

On a country-wide scale, critics worry that official development assistance (ODA) will focus on establishing and expanding microfinance initiatives instead of providing the poor with assistance to meet their basic needs. As the Global Development Research Center articulates, many development experts fear “that official assistance will be diverted from vital primary care aid programs such as health, water projects and education into MFIs, owing to their popularity among donors” (GDRC 2005). Governments facing volatile political, health and economic situations should first focus their resources on addressing pressing health concerns such as HIV/AIDS, malaria and malnutrition prior to utilizing microfinance as part of their country’s developmental

strategy. In countries where microfinance has been adopted as a viable developmental tool, critics cite the pressure on MFIs to reach financial sustainability that diverts them from focusing on the effective provision of financial services to poor clients (Aminur Rahman 1998).

Research shows that in some cases microcredit may entrench poor borrowers further into debt (Montgomery 1996) and force them into an inescapable cycle of loans and repayment. The pressure to repay loans can take a toll on the borrower's family for a number of studies in places such as Peru demonstrate that parents may withdraw their children from school and send them to work in order to make their loan installment (Gonzalez Aguilar 1999, 5). The ILO highlights a 1994 study conducted by USAID in Senegal that shows that microloans increase the workload of female borrowers to such an extent that they are often forced to employ their daughters or daughters-in-law as unpaid employees (ILO 1998). The impact of microfinance on children's welfare must be analyzed contextually and, because therein lies the crux of this paper, the author will expand on this relationship in Bangladesh specifically.

Critics also claim that microfinance is a temporary and shallow solution which fails to address the underlying inequities in the structure of the economy itself. The majority of the world's poor operates in the extralegal, or informal, sector and are excluded from participating in the formal economy because of their financial, legal and educational status. The extralegal sector accounts for 50-75 percent of all working people and one-fifth to two-thirds of the total economic output of the Third World (De Soto 2000, 85). Despite the fact that the informal economy contributes so much to a country's total economic output, politicians and business elites do not want to change the status quo

and eliminate the “structural factors [which] maintain the economic marginalization of the poor” (Goetz and Sen Gupta 1995, 61). Economists Anne Marie Goetz and Rina Sen Gupta explain, “Credit and income-generating programs frame the problem of poverty as a temporary, and easily remedied, cash-flow problem, instead of one which bears on relations of inequality and their institutionalization in broader economic policy” (Goetz and Sen Gupta 1995, 61). In order to address this structural inequity, governments must first admit that it exists. According to economist Hernando DeSoto, “The real problem developing countries face...is the failure of governments to recognize the power, resources, and significance of the extralegal sector” (DeSoto 2000, 102-103).

In many low-income countries with inefficient and corrupt bureaucracies, becoming a formal enterprise or demonstrating ownership of property is so costly, time-consuming and cumbersome that only wealthy business or land owners with an understanding of the financial system can do so. In some instances, countries have not even formalized property rights which prevent the poor from utilizing their property or assets as collateral in order to borrow and protecting themselves from conflicting claims. DeSoto explains that “the result (of not having records or contracts) is that most people’s resources are commercially and financially invisible,” which means that even if poor borrowers gain access to credit and savings through microfinance programs they will still be unable to accumulate the capital requisite of participating in the formal financial sector (DeSoto 2000, 32). In the long run, microfinance initiatives can only do so much to improve the social and economic status of the poor, for without property rights and legal documentation a country cannot and will not truly integrate the poor into the formal economic and legal systems. Though there is no step-by-step plan to do this, however,

many low-income countries need a “crucial change,” which is “adapting the law to the social and economic needs of the majority of the population,” no matter how arduous or impossible it may seem to do so, in order to ensure economic growth and political stability in the long run (DeSoto 2000, 106).

Conclusion

Overall, microfinance has improved the livelihood of millions of poor borrowers who would otherwise be unable to access credit, savings, and other services that enable them to augment their incomes. In order to function more effectively and expand their outreach, MFIs should expand the range of microfinance services offered to better suit the needs of the poorest, combine financial services with social and educational programs and better assess their impact on the community and macroeconomic levels. In order to amplify its effect, microfinance should be complemented with “other interventions like social protection programs, wage employment schemes, education, [and] training... as part of a broader poverty eradication strategy” (Microfinance Gateway 2006). To maximize their potential and eventually reach sustainability, MFIs must tailor their services to serve the needs of a particular target client group based on geographical location, culture, gender, and borrowers’ objectives. Client targeting, monitoring, transparency, and the appropriate integration of microfinance into a country’s developmental strategy may mitigate the negative externalities mentioned earlier. The criticisms outlined in this chapter highlight the fact that there are negative externalities implicit in any poverty alleviation strategy. Though it may not be *the* universal prescription for poverty reduction, microfinance is “an inducer, a catalyst for economic activity of the poor people” that can increase their household income and improve their

lives (Chowdury 2004, 1). Unfortunately, millions of children from poor families have not reaped the benefits of microfinance and have to work so that their families can survive. The next chapter will explain the prevalence of and economic theories behind child labor in order to better understand how to combat it.

Chapter 2: Child Labor – Global Statistics, Legislation and Economic Theories

Public indictments against the use of child labor by companies such as Nike and Gap have garnered media attention in the West over the past decade only to disappear out of the public arena when companies assert that they have ceased to rely upon children to make their products overseas. Despite its diminished international publicity, millions of children continue to work everyday. Child labor is not merely a relic of the past, but an enduring social and economic ill that modern governments must address in order to achieve sustainable economic growth in the long run. More importantly, child labor is a gross violation of some of the most basic human rights: education and freedom from exploitation. Children who work are denied the intellectual development and naïveté that distinguish adolescence from adulthood. Economic conditions and societal factors beyond a child's control or comprehension force them to work. Children lack the knowledge, understanding and bargaining power of their elders and, consequently, it is up to adults to take action and speak out for the millions of children who suffer from the toils of labor. Before taking a stand, however, activists and policymakers must be aware of a number of basic premises within the context of child labor.

Definitions and Statistics

First and foremost, who is a child? A married, thirteen-year-old girl? An eight-year-old street child whose daily activities include taking care of his two-year-old sibling while selling candy and navigating the streets of a city's slums, alone? A sixteen-year-old who is completely dependent upon her parents for her every corporal and emotional need? Societal and religious constructs of childhood vary widely around the world and

even within countries, but the most common definition of a child according to international labor standards is a person between the ages of 5 and 14. Even within these parameters, however, one difficulty in any discussion regarding child labor lies in the breadth and scope of definitions provided by scholars, governments, and international organizations. The International Labor Organization (ILO) identifies three categories of working children ordered according to their level of specificity: economic activity, child labor or hazardous work (ILO 2006, 6). Children who are economically active work at least one hour a week during the regular school week in any productive activity (excluding hazardous forms of labor) which is either paid or unpaid, “for a few hours or full time, on a casual or regular basis, legal or illegal” (Fares and Raju 2007, 2-3). Though this definition seems to be all encompassing, it excludes domestic work in the child’s household and school attendance. The category of economically active children has no legal significance because it is merely a statistical one. According to the ILO’s most recent data, 190.7 million, or 15.8 percent, of the world’s 1.2 billion children between the ages of 5-14, are economically active¹ (ILO 2006, 6). Though this statistic seems daunting, the number of economically active children in the world has declined by 9.6 percent since 2000, when 211 million children fell into this category (ILO 2006, 6).

Within this comprehensive definition of economically active children, child labor receives the most attention. Child labor includes: i) all children between the ages of 5-11 who are economically active, ii) children between the ages of 12-14 who work in an

¹ ILO data on child labor is collected by its Statistical Information and Monitoring Program on Child Labor (SIMPOC). SIMPOC statistics are based on its own national surveys; World Bank’s Living Standards Measurement Study (LSMS) surveys; the Multiple Indicator Cluster Surveys (MICS) conducted by the United Nations Children Fund (UNICEF); labor force surveys; the United Nations Population Division; and the inter-agency Understanding Children’s Work (UCW) Project (ILO 2006, 5).

economic activity for 14 or more hours per week, and iii) children between 12-17 who work in “the worst forms of child labor” (Fares and Raju 2007, 3). According to the ILO, 165.8 million, or 13.7 percent, of the world’s children aged 5-14 were engaged in child labor in 2004 (ILO 2006, 6). Again, this statistic seems grim, but the worldwide incidence of child labor has decreased 11 percent since 2000, from 186.3 million (ILO 2006, 6). The most troubling group of economically active children are those engaged in hazardous work which is “any activity or occupation that, by its nature or its type, has or leads to adverse effects on the child’s safety, health (physical or mental) and moral development” (ILO 2006, 6). Hazards include excessive workload and working hours, psychological and physical abuse and dangerous physical conditions. In 2004, 74.4 million, or 6.2 percent, of children between the ages of 5-14 were engaged in hazardous work (ILO 2006, 6). Fortunately, the most promising strides in the fight to reduce child labor are among the most vulnerable children; from 2000 to 2004, the incidence of children participating in hazardous work between the ages of 5-14 dropped 33.2 percent (ILO 2006, 6). The worst forms of child labor² fall into this category and include: i) slavery of economic activity in slave-like conditions, ii) prostitution or pornography, iii) illicit activities such as drug production and trafficking, and iv) economic activities that are likely to harm the health, safety, or morals of the child (Fares and Raju 2007, 3). Though over a hundred million children are still impeded in their ability to receive an education and have time for leisure, the progress achieved by child advocacy groups provides hope for eradicating child labor, especially in its most hazardous forms.

² Convention 182 enacted in 1999, established the “worst forms of child labor.” See ensuing paragraphs for further details.

Despite the specificity and general acceptance of these categories, scholars and organizations such as UNICEF have criticized the ILO for failing to incorporate unpaid domestic labor in a child's own home into their estimates of child labor. Because girls do the majority of household work, which often inhibits or prohibits them from attending school, excluding their household contributions from the realm of economic activity severely underestimates their participation relative to that of boys (Basu and Tzannatos 2003, 156). In her study of child labor in India, economist Neera Burra concludes that a significant portion of child labor appears "invisible to the casual observer" (Burra 1997, 204). In fact, empirical research by the Indian National Council of Economic Research demonstrates that if child labor estimates include own-household, unpaid work, girls in India actually do 33 percent more work than boys (Cigno and Rosati 2001). The gross underestimation of the number of girls who work creates a gender bias in child labor statistics. As scholars Kaushik Basu and Zafiris Tzannatos explicate, "If this correction of 33 percent is made to the adjusted estimate of economically active children, the number goes up to somewhere between 425 and 477 million. This would mean that close to 40 percent of the world's children are economically active" (Basu and Tzannatos 2003, 156). This implies that legislative policies should be designed to specifically target girls by promoting and ensuring their equal right to an education. Additionally, scholars critique the ILO's assessment of economic activity because of its reference period. Economically active children are those who responded affirmatively when asked whether or not they have worked for one or more hours in the past week. A one-week survey period fails to capture the "frequent entry and exit of children" (Fares and Raju 2007, 3) in the labor market and inflates the number of children engaged in economic activity. As a result of

these ambiguities in the definition of economically active children, multilateral organizations and academics analyze the incidence of and issues facing working children in terms of child labor.

Global Child Labor Patterns

In reviewing the global statistics on child labor, important patterns emerge that can aid policymakers in creating more effective and targeted legislation to decrease the number of children who work in the world today. In 2004, the ILO found that 18.8 percent of children in Asia and the Pacific, 5.7 percent of children in Latin America and the Caribbean, 26.4 percent of children in sub-Saharan Africa and 5.2 percent of children in other regions were economically active (ILO 2006, 7). Africa has the highest rate of child economic activity, for one out of every five children work; contrary to global trends, girls are much more likely to work than boys on the continent (Fares and Raju 2007, 8). In a global survey of child labor using ILO statistics from 59 countries, scholars Jean Fares and Dhushyanth Raju conclude that boys are much more likely to work than girls, especially in hazardous work, and that the ratio of working boys to girls is 3:2 (Fares and Raju 2007, 9).

Boys are also more likely to work in agriculture which makes it the dominant economic activity for child laborers. The ILO estimates that 69 percent of economically active children work in the agricultural sector; 22 percent work in the services sector; and 9 percent work in industry (ILO 2006, 7).³ A reliance on primary commodities and

³ The agricultural sector includes farming, hunting, forestry, and fishing activities. The services sector is comprised of wholesale and retail trade, restaurants and hotels, transport, storage, and communications, finance, insurance, real estate and business services, and community, social and personal services. The industrial sector encompasses mining and quarrying, manufacturing, construction and public utilities (ILO 2006, 7).

agricultural exports often characterizes low-income, low-growth countries; therefore it logically follows that these countries would have a higher incidence of child labor. In fact, even after controlling for income and literacy levels, Fares and Raju find a strong positive correlation between agriculture's share of GDP and the incidence of child labor worldwide: a one percentage point increase in the share of agriculture in GDP is associated with a 3.2 percent increase in the share of children working (Fares and Raju 2007, 13). Moreover, agriculture is primarily a rural economic activity that requires more involvement and labor than the economic activities of the urban environment. Consequently, children in rural areas tend to work more and for longer hours: out of 55 MICS countries, 31 percent of rural children 5-14 are engaged in market work compared to only 19 percent in urban areas (Edmonds 2007, 19). Domestic work is more prevalent in rural areas and the incidence of unpaid market work is nearly double in rural areas (Edmonds 2007, 19). Market work is much more common in urban areas since there is both a higher population and greater wealth in cities.

Whether in rural or urban areas, domestic work dominates global child labor according to economist Erik Edmonds. Edmonds finds that 65 percent of children 5-14 reports working in domestic work while only 23 percent participate in market work (Edmonds 2007, 19). Children work more hours per week in domestic rather than market work, and because girls are much more likely to participate in domestic work, this finding supports the aforementioned conclusion that global statistics grossly underestimate the incidence of female child labor. Using UNICEF's MICS⁴ statistics from 55 countries,

⁴ MICS is the Multiple Indicator Cluster Survey is a household survey used by UNICEF to assist countries monitor the situation of a country's women and children. The countries include Albania, Georgia, Macedonia, Tajikistan, Ukraine, Belarus, Kazakhstan, Montenegro, Turkmenistan, Uzbekistan, Bosnia and

Edmonds highlights the fact that countries with the highest prevalence of work outside of the household also have the highest rate of work inside the household. Sierra Leone has the highest rate of children working outside the household and second highest rate of work inside the household (Edmonds 2007, 16). These statistics illustrate the incapacity of many low-income countries to regulate child labor due to weak institutions and legal infrastructure. Furthermore, this phenomenon highlights the inherent challenges in implementing and enforcing the international laws that protect the rights of working children.

International Legislation

A large body of international legislation sets minimum age standards for employment and seeks to protect children from working in hazardous conditions. The first of these was the Minimum Age (Industry) Convention of 1919, which resulted from the high incidence of child labor during the Industrial Revolution. At the core of child labor legislation is the ILO Minimum Age Convention (No. 138) of 1973. Convention 138 mandated that signatories establish a minimum age of employment and restrictions on working hours as well as pursue policies to abolish child labor. Member parties explicitly agreed that the minimum age of employment would not be “less than the age of completion of compulsory schooling, and, in any case, shall not be less than 15 years of age” (ILO 1973, 2). One of the most recent pieces of legislation was the ILO Worst Forms of Child Labor Convention (No. 182) adopted in 1999. Under the terms of this

Herzegovina, Kyrgyzstan, Serbia, Lao, Mongolia, Thailand, Vanuatu, Vietnam, Burundi, Kenya, Malawi, Somalia, Algeria, Lebanon, Occupied Palestinian Territory, Syria, Tunisia, Djibouti, Palestinians in Lebanon, Sudan, Palestinians in Syria, Yemen, Iraq, Morocco, Bangladesh, Belize, Dominican Republic, Jamaica, Trinidad and Tobago, Suriname, Cuba, Guyana, Burkina Faso, Cote d'Ivoire, Guinea Bissau, Nigeria, Sierra Leone, Cameroon, Gambia, Mauritania, Sao Tome and Principe, Togo, Central African Republic, Ghana and Niger. Source: UNICEF.

Convention, children are defined as all those under the age of 18 in order to maximize the scope of this legal protection. All members parties are to determine their own definitions of “activities likely to harm to health, safety, or morals of the child” according to cultural and social standards (ILO 1999,1). As a result of the disparate standards of the world’s many countries, the parameters and effects of Convention 182 are often ambiguous.

The Convention on the Rights of the Child (CRC) was adopted by the United Nations (UN) in 1989 and came into force in 1990. Every UN member has ratified the CRC except for the U.S. and Somalia. The CRC outlines the social, economic, and cultural rights of all persons under 18. It seeks to protect children from situations that are not in their best interest and upholds parental responsibility for children’s welfare. Article 32 is the most significant article in the context of child labor and begins:

State parties recognize the right of the child to be protected from economic exploitation and from performing any work that is likely to be hazardous or to interfere with the child’s education, or to be harmful to the child’s health or physical, mental, spiritual, moral or social development (UN 1989, 9).

All signatories have committed to take political and social action to ensure that children have access to education and protection from participating in hazardous economic activities. This includes setting a minimum legal age for work, to be established domestically in each nation; regulating the hours and conditions of employment; and punishing firms and individuals who violate these laws (UN 1989, 10). The modern international system has enabled the creation of these agreements to target low-income, low-productivity countries that continue to utilize working children in the production of goods for export, however, child labor has not been historically endemic to only low-income countries.

Economic Theories of Child Labor

There were more child workers during the Industrial Revolution in 19th century England than the total number of children engaged in economic activity in 1998, excluding middle Africa (Basu and Van 1998, 414). In 1851, 36.6 percent of boys 10-14 and 19.9 percent of girls of the same age range worked in England even though legislation prohibited their labor market participation (Basu and Van 1998, 414). Thus, despite England's high growth rates during this epoch, a highly significant portion of the child population worked. This economic situation may seem paradoxical to the average reader who intuitively attributes child labor to poverty, but, in contrast, it highlights that a broad array of social, cultural and economic factors interact to engender children's participation in economic activities. Though there are disagreements within academia as to what causes children to work, economics are integral to any analysis of child labor because wages and labor participation are pillars of all functioning economies. There are two schools of thought regarding the root of child labor within the economic literature. One school of economics believes that child labor causes poverty vis-à-vis the intergenerational transmission of low levels of education, i.e. the deficit of human capital accumulation, creating a so-called "child labor trap" (Wahba 2003). The other vein asserts that poverty causes child labor by creating economic constraints within households that make the economic activity of children optimal or even necessary for survival.

Macro and micro-economic analyses of the relationship between poverty and the incidence of child labor widely vary upon their conclusions. On the macroeconomic level, a number of economists provide data demonstrating a strong and negative

correlation between national income level (GDP) and child labor worldwide (Beegle, Dehejia, and Gatti. 2002; Edmonds and Pavcnik 2005; Orazem and Gunnarsson 2003). In their cross-country analysis of child labor, scholars Erik Edmonds and Nina Pavcnik find that variation in GDP per capita explains 73 percent of the variation in the economic activities of children (Edmonds and Pavcnik 2005, 210). A World Bank-sponsored study conducted by economists Peter Orazem and Victoria Gunnarsson finds that the correlation coefficient between child economic activity rates and GDP per capita across countries is -0.82 (Fares and Raju 2007, 12). In 1995, the incidence of child labor was 2.3 percent among countries in the upper quartile of GDP per capita and 34 percent among countries in the lowest quartile of GDP per capita (Beegle, Dehejia, and Gatti 2002, 1). In the world's poorest countries, or those in the 25th percentile of GDP per capita (roughly \$1,200), a \$100 increase in GDP per capita is associated with a 4.7 percent decrease in the share of children working (Beegle, Dehejia, and Gatti 2002, 1). These findings highlight the robust impact of economic growth in reducing child labor and demonstrate the increased import of policies to achieve economic progress in the lowest-income countries. This contemporary data is consistent with the historical observation that child labor has drastically declined in countries that have experienced high levels of economic growth, i.e. Britain, China, and the U.S. Unlike the significant negative correlation between income level and child labor globally, household-level analyses produce variant results that demonstrates the influence of social, cultural, and institutional factors on a household's labor market decisions.

Positive Correlation between Poverty and Child Labor

In 1960, University of Chicago economist Theodore W. Schultz first posited that households decide whether or not to send their children to work or school by weighing the relative returns between foregone wage contributions of children in the short-run and returns on human capital formulation in the long-run (Schultz 1960, 571). In their seminal 1998 paper, Kaushik Basu and Pham Hoang Van created one of the most influential economic models of child labor. Basu and Van assert that household income level is the primary determinant of child labor and that parents do not want their children to work, thus if household incomes rise, children work less. In this model, there can be multiple equilibria in the labor market: one in which wages are low and children work and another in which wages are high and children do not work (Basu and Van 1998, 413). If adult wages are low, more children will be forced to work in order to complement the adult earnings in their household and reach a subsistence income level. If adult wages are high, there is no need for parents to send their children to work. This model rests upon two assumptions: the Luxury Axiom and the Substitution Axiom. The Luxury Axiom states: "A family will send the children to the labor market only if the family's income from non-child labor sources drops very low" (Basu and Van 1998, 416). This Axiom is based upon the assumption that non-work, or children's education and leisure, is a luxury good that only the non-poor can afford as well as the idea that parents make household labor decisions based on altruism and do not wish their children to work. The Substitution Axiom upholds that from a firm's point of view, child labor is a substitute for adult labor (Basu and Van 1998, 416).

Consequently, the child wage determines the firm's demand for effective labor because adults and children are substitutes in the market. Therefore, child labor market

participation depresses adult wage and makes child labor necessary (Edmonds 2007, 36). In industrialized countries with multiple equilibria and high productivity, children do not participate in the labor market because parents are able to support their children due to a higher wage rate. Contrarily, low-income countries with an excessive labor supply, little technological innovation or capital investment, have an unproductive labor force that creates a new market equilibrium where child labor is necessary. In this scenario, children's participation in the labor market creates an excess supply of labor that depresses adult wages and creates poverty. This low-wage equilibrium characterizes Europe during the Industrial Revolution at the end of the 19th century. The labor market in low-income countries is distinguished by having only one equilibrium and thus, when a government imposes a legislative ban on child labor, adult wages increase, however, they still remain less than the level they would be without the participation of children in the labor market. As a result, all households are worse off as they cannot complement the low adult wage with child labor wages.

In these low-income countries, governments often attempt to eliminate child labor vis-à-vis policies that aim to provide a more equitable distribution of resources and increase household wealth. Economists Kenneth A. Swinnerton and Carol Ann Rogers, however, find that in low-productivity countries, i.e. those with a real GDP per worker of \$10,000 or less, government policies that redistribute income will not reduce child labor and may even increase the number of working children (Swinnerton and Rogers 1992, 2). The reasoning behind this concept is that the poorest families will benefit from the more equal distribution of resources, but not enough to withdraw their children from the labor market. Meanwhile, wealthier families on the margin of poverty may experience a

decrease in their household incomes and may be forced to send their children to work. Swinnerton and Rogers claim that in high-productivity countries, income inequality causes child labor and consequently, income redistribution will be effective in curtailing the incidence of child labor. In low-productivity countries, governments should focus their policy efforts on increasing productivity regardless of its impact on equity. Outside of this model, if policymakers do not take equity into account in their legislative decisions then it seems inevitable that destitute families will never be able to escape from the chains of poverty and its many symptoms including child labor.

Households in these low-growth, low-productivity economies whose children must work in order to reach a subsistence income level are said to be caught in a so-called “child labor trap” as working children are inhibited from human capital accumulation, i.e. education. A number of empirical studies support the “child labor trap.” Using data collected from Egypt, Jackline Wahba (2003) finds that the child of a parent who was a child laborer has a higher probability of being a laborer than the child of a parent who was not a child laborer. Patrick M. Emerson’s and André Portela Souza (2003) research based on Brazilian labor statistics concludes that having worked as a child has a larger impact on whether or not an adult’s child will work than the fact that the adult’s household is poor. Parents often do not internalize the long-term detrimental effects of sending their children to work because they have neither the luxury of doing so since short-term income is essential to their survival. Furthermore, parents in low-income households do not make resource allocation decisions within a long time horizon as they often live “hand-to-mouth” and do not know what the future may bring. Another reason parents may not understand the high social costs of child labor is because it is a social

norm; therefore, external intervention notwithstanding, there is no reason for parents to value their children's enrollment in school over participation in the labor market which gives children practical skills that may enable them to get a higher paying job in the future, though certainly will not be comparable to those learned in school.

In high-income countries where a legislative ban on child labor has become endogenous, society believes that educating their children is morally imperative and that sending their children to work is immoral, a concept that Basu and Van deem "acquired morality"; in countries where child labor is the accepted social norm, "the moral rejection of child labor has not yet been acquired" according to Basu and Van (Basu and Van 1998, 422). Though it is true that child labor is abhorred and legally prohibited in wealthier countries, this idea implies that Western morals and social constructs are superior and more advanced than their low-income counterparts. Parents in poor households are constrained in their labor market decisions due to trade-offs between short-run and long-run consumption. It is often impossible for poor parents to make long-term investment decisions as their family's immediate survival depends on only their meager incomes.

Poverty not only impedes the ability of parents to send their children to school, but also prohibits families from allocating resources efficiently. In their influential paper, "Is Child Labor Inefficient?" Jean-Marie Baland and James A. Robinson assert that child labor is a symptom of poverty and claim that it is Pareto inefficient⁵ because "parents fail to fully internalize its negative effects" (Baland and Robinson 2000, 663). The basic assumption of their model is that there is a trade-off between child labor and education.

⁵ Pareto efficiency is an economic equilibrium in which no individual actor can be made better off without making another individual actor worse off.

Because long-run returns to human capital accumulation are higher than those of short-run consumption, child labor is inefficient. When parents have no assets to leave to their children and lack access to credit as a substitute for foregone income, they are unable to sacrifice their child's current wage contribution in return for their child's higher earning potential as an adult. In this scenario, parents fail to internalize the negative repercussions of sending their child to work instead of school; this is not because they lack altruism towards their children, but it is instead because they are unable to invest in the education of their children in the short run. Parents do not internalize the negative impact of this decision, but their children will in the future. Consequently, child labor is inefficient when parents use it as a substitute for a future income transfer from their children or as a substitute for borrowing in an imperfect market (Baland and Robinson 2000, 677). The conclusion that not sending children to work is a luxury that only the non-poor can afford is consistent with Basu and Van's Luxury Axiom (1998).

Other scholars also provide evidence supporting the strong negative correlation between household income level and child participation in the labor market. In his study of Vietnam, Edmonds (2003) finds that child labor declines dramatically at the poverty line (based on 1993 data) and increases in per capita income explain 80 percent of the decline in child labor in households that exit poverty. In their analysis of child labor in the global economy, Nina Pavcnik and Edmonds (2005) explain that there is a strong negative relationship between household living standards and the incidence of child labor. They conclude, "Child labor seems highly responsive to unexpected changes in the family's economic environment," therefore mitigating household income volatility may decrease the likelihood that children will work (Edmonds and Pavcnik 2005, 209). In

contrast, a number of economists provide evidence which suggests that there is a weak correlation between household income level and child labor, and instead attribute the incidence of child labor to a variety of other economic, social and cultural variables.

Weak Relationship Between Poverty and Child Labor

In his study of Pakistan and Peru, economist Ranjan Ray (2000) finds an insignificant correlation between household income and child labor, although he does find a negative and highly significant relationship between child labor and educational attainment. Ray highlights that divergent cultures and community structures across countries create different interactions between adult and child labor. According to his data, adult males and children are “substitutes” in Peruvian household labor market decisions while adult female and child labor are “complements” in Pakistan (Ray 2000, 11). This implies that as adult male wages increase in Peru, children are less likely to work while as female adult wages increase in Pakistan, children are more likely to work. The complementary nature of adult female and child labor in Pakistan is inconsistent with Basu and Van’s assumption of parental altruism in their Substitution Axiom (Ray 2000, 12). In Pakistan, if adult female wages increase mothers are more likely to take their children, usually girls, to work with them. Ray attributes this phenomenon to “the lack of good schools and child care facilities in Pakistan” and posits that there is a “close causal link between a deteriorating community infrastructure and rising child labor” (Ray 2000, 12). Children in non-poor households are much more likely to be enrolled in school than their poor counterparts which suggests that Basu and Van’s Luxury Axiom is true in the context of child education (i.e. education is a luxury good that only the non-poor can afford to consume) (Ray 2000, 16). The negative, highly significant correlation between

child employment and education implies that child labor is the greatest obstacle to school attendance which keeps children caught in a “child labor trap” through the intergenerational transmission of poverty (Ray 2000, 16).

It is interesting that Ray finds that Peruvian children work *and* attend school while more children, especially older girls, drop out of school completely to enter the labor market in Pakistan. This discrepancy suggests that cultural factors and the availability of quality schools have a large role in determining whether or not a working child, especially a girl, goes to school. Edmonds and Pavcnik assert that most children who work also attend school and UNICEF estimates that nearly 74 percent of working children also attend school (Orazem and Gunnarsson 2006). As a caveat to this data, Fares and Raju find that countries with higher rates of child labor also have higher rates of children working *and* not attending school (Fares and Raju 2007, 7). Despite their enrollment, economist George Psacharopoulos concludes that child labor reduces educational attainment by an average of two years and greatly contributes to grade repetition in Bolivia and Brazil (Psacharopoulos 1997, 377). Ray’s data implies that in order to increase the likelihood that children will go to school instead of participating in economic activities, investments must be made to improve social and community infrastructure (i.e. the increased provision of public goods such as education, water, sanitation, electricity) and living conditions. As Edmonds and Pavcnik suggest, poor local institutions may leave children with few available options besides work and thus, improving local schools provides children with an alternative to work or idleness (Edmonds and Pavcnik 2005, 209). Economist Kiran Bhatta (1998) highlights the

influence of societal factors such as an aversion to idleness in his study of India. He finds:

Income and related variables do not seem to have any direct significant effect on children's work input [...] it is not a financial imperative that forces children to work [...] children are often put to work as a deterrent to idling rather than as an economic necessity (Bhatty 1998, 1734).⁶

Avoiding idleness is a particularly useful in explaining the high incidence of child labor in urban areas and slums where idle children often fall victim to drug use and organized crime. Ray's data from Peru and Pakistan also demonstrates that increasing levels of adult female education and awareness significantly reduces child labor (Ray 2000, 18). Educating women about the ills of child labor and the benefits of sending their children to school is a powerful tool to diminish the incidence of child labor. Microfinance institutions and NGOs may provide this education, however, the effectiveness of these social education programs on the share of working children depends upon the aims of the particular organization and the area's vulnerability to exogenous shocks.

Despite the empirical findings that macroeconomic income growth has a positive effect on eliminating child labor at the global level, several economists provide further evidence that the same does not hold true on a micro-level. Rogers and Swinnerton (2003) demonstrate that when poor households lack access to credit, an increase in parental income can perversely cause child labor to rise. This model analyzes household resource allocations in two phases: first, childhood in which a child is completely dependent upon his parents, and second, the child's adulthood in which the child moves out of the house and is self-sufficient. Once a household reaches a certain income level, children no longer see the need to transfer assets to their parents when they are older.

However, their parents would still like a repayment for the investments they made in the child's youth. At this increased income level, parents anticipate that their children will not repay them in the future and therefore maximize present utility by sending their children to work. This counterintuitive argument may not hold true in the real world, but it does highlight the significance of short-term and long-term tradeoffs between a child's economic contribution to the household and a child's human capital accumulation.

There are a number of empirical studies supporting Rogers and Swinnerton's (2003) conclusion that an increase in household wealth makes parents more likely to send their children to work. Based upon data from Vietnam, Edmonds and Turk (2004) find that households that start their own businesses are more likely use child labor. Data collected by Ramesh Kanbargi and P.M. Kulkarni (1991) in rural India suggests that there may be a positive relationship between a household's number of cattle and the incidence of child labor. Similarly, economists Sonia Bhalotra and Christopher Heady (2003) conclude that children who live in households with greater land ownership tend to work more based on data from Ghana and Pakistan. The explanation for these findings is that labor market imperfections create the opportunity for households to use their labor endowments, including child labor, more productively to augment their household income level (Basu and Tzannatos 2003, 159). Bhalotra and Heady appropriately label this positive correlation the "Wealth Paradox," for if income level and child labor are inversely correlated as so many scholars posit, then once household income reaches a certain threshold child labor should decrease. Though this may be true in a small sample of case studies conducted around the world, there is a significant negative correlation between income, i.e. GDP per capita, and the incidence of child labor at the global level.

As household income levels increase parents may be less likely to send their children to work although, as chapter three of this thesis highlights, this is not always the case.

Positive Relationship between Credit Constraints and Child Labor

Credit enables households to substitute foregone consumption in the short term for long-term investments. The poorly developed financial and legal infrastructures characteristic of low-income countries prevent the majority of the population from obtaining credit, savings and insurance. Weak property rights impede the ability of the poor to transform their dead capital, i.e. collateralizable assets and property, into fungible assets such as collateral for credit which mitigates the impact of exogenous, negative shocks such as loss of employment, death, natural disaster, fire and crop failure, on household consumption. As a result, if a negative exogenous shock suddenly decreases household income, poor households may be forced to send their children to work as a substitute for credit. Little empirical research on the direct relationship between credit constraints and child labor exists to date, though a growing number of scholars have attempted to capture the effect of access to credit on the likelihood that a household will send its children to work. Hanan G. Jacoby and Emmanuel Skoufias (1997) indirectly demonstrate that “poor households lacking access to credit markets might draw upon child labor when faced with negative income shocks” in their empirical study of six Indian villages (in Beegle, Dehejia, and Gatti 2002, 6). The authors find that “fluctuations in school attendance” indicate that children’s labor is “used by households as self-insurance” (Beegle, Dehejia, and Gatti 2002, 6). Using school attendance as a proxy for child labor, however, assumes that work and school are substitutes, which is not always the case.

Scholars Katherine Beegle, Rajeev Dehejia, and Roberta Gatti (2004) employ more correlative variables in order to assess the relationship between credit constraints and child labor. Using collateralizable assets⁷ as a proxy for access to credit, Beegle and her colleagues find that households with collateralizable assets are better able to offset the negative effects of income shocks in the Kagera region of Tanzania (Beegle, Dehejia, and Gatti 2004, 2). This coping capacity could be due to the “Wealth Effect,” or “unobservables such as a household’s social network,” however, when these effects are controlled for their results remain robust (Beegle, Dehejia, and Gatti 2004, 2). In a cross-country study, Dehejia and Gatti provide some of the most compelling evidence that there is a significant negative correlation between child labor and credit constraints by utilizing the extent of financial intermediation⁸ as a proxy for credit constraints (Dehejia and Gatti 2002, 2). In countries with “underdeveloped” financial markets, income volatility has a much more significant impact on the incidence of child labor than countries with well-developed markets (Dehejia and Gatti 2002, 2). Because child labor is more prevalent in countries with “underdeveloped” financial markets, this observation suggests, “that households resort to their children’s work to cope with income shocks” (Dehejia and Gatti 2002, 2). Because poor households lack the assets and access to credit necessary to absorb exogenous decreases in their income, parents are forced to utilize the household’s only alternative productive capacity: their children’s labor.

Elaborating upon Van and Basu’s Luxury Axiom, economist Priya Ranjan upholds, “It is a combination of poverty and missing market for loans against future

⁷ Collateralizable assets are represented by the value of durable goods such as radios, bicycles, fans, lamps, and pots and exclude cash holdings, business, and land value in this model (Beegle et. al 2004, 11).

⁸ Financial intermediation is determined in their model as the share of private credit issued by banks to GDP (Beegle, Dehejia, and Gatti 2004, 20).

earnings that generates the phenomenon of child labor” (Ranjan 1999, 100). Parents in poor households cannot afford to withdraw their children from the labor market and incur the loss of their wage contribution because there is simply “no market for loans against future earnings” (Ranjan 1999, 100). Consequently, despite high returns to human capital, it is economically infeasible for parents to invest in their children’s education because “borrowing against the future earnings of children is [simply] impossible” (Ranjan 2001, 82). If parents have access to loans or receive school subsidies which enable them to offset the economic losses incurred by investing in their children’s education, then they may withdraw their children from work. Dehejia and Gatti support this hypothesis with empirical evidence that “a move from the 25th to the 75th percentile of access to credit in a poor country is associated with a 4.2 percent decrease in child labor” (Dehejia and Gatti 2002, 13). In contrast, in a report sponsored by the Understanding Children’s Work joint project between the ILO, UNICEF, and the World Bank, scholars Lorenzo Guarcello, Fabrizia Mealli, and Furio Camilo Rosati find that credit constraints have a larger impact on “household investment decision in human capital, rather than children’s labor force participation” (Guarcello, Mealli, and Rosati 2002, 21). Thus, having access to credit increases the likelihood that parents will send their children to school instead of work while, “shocks, on the contrary, directly affect children’s labor force participation, most likely because of the need to compensate for unexpected loss of resources” (Guarcello, Mealli, and Rosati 2002, 21).

Despite their divergent variables, sample sizes, and conclusions, all of these reports demonstrate that there is a correlation between income shocks, credit constraints and child labor that has clear policy implications: providing poor families with access to

credit may reduce the likelihood that they will have to send their children to work in order to maintain a subsistence level of income. Up to this point economists have only indirectly measured the effect of credit constraints on child labor because it is difficult to capture a household's access to credit with a single quantitative variable. The aim of this thesis is to analyze the direct relationship between the elimination of credit constraints and the incidence of child labor in Bangladesh.

Conclusion

The crux of these economic models is that poor households face a trade-off between short and long run economic and social costs upon which their family's survival may depend. In the short run, parents may be forced to send their children to work because they lack access to credit or savings as substitutes for the wages foregone by investing in their children's education. In some places, child labor may be socially normalized to such an extent that parents do not internalize the detrimental effects of child labor on the well-being and future earning capacity of their children if they go to school. Economic models are useful in analyzing household labor market decisions and demonstrating a correlation between child labor and a number of economic indicators, however, individuals cannot always be assumed to be rational actors. Political, social and cultural factors all play a role in determining whether or not a child works, attends school or does both. If a government has poor institutions and infrastructure, the quality of education and living standards may be low and children will be less likely to attend school. If child labor is the norm, then households may value the perceived life skills acquired by work over education and society may not view child labor as unacceptable. Finally, if parents worked as children, then they are more likely to send their children to

work, due to either economic or personal reasons, and believe that their children are acquiring important life skills through employment. The myriad causes of child labor cannot be analyzed in a vacuum. Nevertheless, the economic theories presented in this chapter are integral to understanding household labor market decisions and subsequently enact legislative policies to more effectively diminish the incidence of child labor. In the next chapter, I will use these studies and models to untangle the complex relationship between microfinance and child labor in Bangladesh.

Chapter 3: The Relationship Between Microfinance and Child Labor in Bangladesh

Home to thousands of microfinance programs and millions of working children, Bangladesh is the ideal location to study the relationship between the two. Though there is an abundance of research documenting the impact of microfinance on household income and consumption levels and the factors that lead children to work, to the author's knowledge, there are no studies on the relationship between the two. Interestingly enough, there are many overlapping factors that contribute to both the pervasiveness of microfinance and child labor in Bangladesh including: geography, culture, demographics, poor governance, and inadequate access to education. Though scholars and policymakers uphold Bangladesh as a prime example of the capacity of microfinance programs to diminish poverty and improve household welfare, access to credit can potentially exacerbate the endemic child labor problem there.

General Overview

Bangladesh is a land of deltas surrounded by India and bordering Myanmar in the southeast. In this aqueous setting, approximately 145 million people compete over land in a territory equivalent to the size of Iowa making it one of the most densely populated countries in the world. There are three main seasons in Bangladesh: summer, which is hot and humid, a mild winter, and monsoon season during which 20-60 percent of the country floods. As a consequence of its geographical position in the Bay of Bengal, Bangladesh is extremely vulnerable to fluctuations in sea levels and natural disasters such as cyclones, typhoons and earthquakes. In September 2007, a cyclone ravaged the country killing more than 3,500 people and rendering millions more homeless.

Unfortunately, Cyclone Sidr was the latest of the numerous hardships the people of Bangladesh have faced since the departure of British colonial forces from India.

Figure 3.1: Map of Bangladesh



Source: <http://www.chaitanyaconsult.in/chaitanya/vision/bdmap.jpg>

After gaining independence from the British in 1947, India, inhabited primarily of Hindus, and Pakistan, dominated by Muslims, emerged as two independent nation-states. Pakistan comprised two regions straddling India known as East and West Pakistan.

People in East Pakistan felt politically neglected and economically exploited. The central government's ignorance of victims of a catastrophic flood in East Pakistan in 1970, exacerbated tensions and incited a full-scale rebellion against the central government in Islamabad. In 1971, West Pakistani soldiers brutally suppressed a resistance movement in East Pakistan utilizing torture, rape, death squads, and murder; Bangladeshis refer to this attack as genocide. In one night alone, roving death squads murdered 7,000 people in Dhaka. Scholars estimate that somewhere between one and three million Bengalis were killed between 1969 and 1971 under President Yahya Khan's reign over the Pakistani territories (Rummel 1994, 331). In order to escape this violence, ten million refugees fled to India where dissidents formed a provisional government determined to liberate the people of East Pakistan from their oppressor to the west. Inhabitants of East Pakistan waged war on the central government not only to assert their economic and political autonomy, but also, and perhaps more importantly, in order to claim the right to speak Bengali, not Urdu, as the national language. In 1971, a pre-emptive Pakistani air attack and a diminishing capacity to absorb/support the huge refugee population catapulted India into the war on behalf of Bangladesh. After only eleven days, the Indian army crushed that of West Pakistan and on December 16, 1971, Bangladesh was born.

In 1974, the monsoon season caused excessive floods that led to famine. The death toll according to the Bangladeshi government was merely 26,000 people, however, most scholars estimate that at least a million people died as a result of food shortages. Military coups and martial law continued until President Zia established democracy in 1979. In 1981, military leaders reclaimed their authority and political instability ensued until 1991, when Bangladesh truly became a democracy. Bangladesh is a parliamentary

democracy known for its elite-driven politics and rampant corruption now governed by an interim caretaker military government. One character that distinguishes Bangladesh from other Muslim nations is its moderation. Though 88 percent of its population is Muslim, language is at the heart of the Bangladeshi national identity (BBS 2006). During the War of Partition in 1971, the people of Bangladesh fought fiercely for the freedom to speak Bangla; 98 percent of citizens speak it (BBS 2006). This cultural cohesion may have earned Bangladeshis political autonomy, but it did not engender economic success. Figure 1 presents political risk indicators from the International Country Risk Guide that illustrate the high levels of corruption, crime, military involvement, poverty and unemployment which render the country a politically, “very high risk” and detract from foreign investment (The PRS Group, Inc. 2008).

Table 3.1: Governance Indicators in terms of Political Risk Ratings

Variable	Political Risk Rating	Scale
Bureaucracy Quality (L)	2	4 = high
Corruption (F)	2.5	0 = most corrupt 6 = least corrupt
Democratic Accountability (K)	3	0 = autarchies 4 = alternating democracies
Government Stability (A)	8	12 = most stable
Law & Order (I)	2.5	0 = very high crime rates and ignorance of laws 6 = strong law and order
Legislative Strength	3	4 = high quality
Military in Politics (G)	1.5	0 = highest degree of military involvement
Political Risk Rating	49.5	0.0% - 49.9% = very high risk
Poverty	0	0 = very high risk
Risk for GDP per Head	0	0 = up to 9.9 % of avg. estimated total GDP of all countries covered by ICRG
Unemployment	0	0 = very high risk

SOURCE: The PRS Group, Inc. International Country Risk Guide, Feb. 2008.

Table 3.2: World Bank Country Policy and Institutional Assessment (CPIA) of Governance

Variable	2005
CPIA quality of public administration rating (1=low to 6=high)	3
CPIA social protection rating (1=low to 6=high)	4
CPIA structural policies cluster average (1=low to 6=high)	3
CPIA transparency, accountability, and corruption in the public sector rating (1=low to 6=high)	2

SOURCE: World Bank Development Indicators Database

Economy

Bangladesh is a young country whose economic progress has been impressive over the past few decades, but remains an impoverished nation relative to global standards. Even though Bangladesh experienced an average annual growth rate of 4.8 percent between 1991 and 2000, 80 percent of the population continues to live on less than \$2 a day (Bangladesh Bank). Because of the abundance of cheap labor, services accounted from 52 percent of Bangladeshi GDP in 2007, with manufacturing and agriculture contributing 27 and 22 percent respectively (World Bank Development Indicators 2007).

Table 3.3: Economic Indicators 2000-2006

Variable	2000	2003	2004	2005	2006
Agriculture, value added (% of GDP)	26	22	21	20	20
GDP growth (annual %)	6	5	6	6	7
GDP per capita (constant 2000 US\$)	365	399	416	433	454
GDP per capita growth (annual %)	4	3	4	4	5
GDP per capita, PPP (constant 2000 international \$)	1543	1685	1757	1828	1916
Imports of goods and services (% of GDP)	19	20	21	23	24
Exports of goods and services (% of GDP)	14	14	15	17	18
Inflation, consumer prices (annual %)	2	6	9	7	7
Manufactures exports (% of merchandise exports)	91	92	90	..	.

SOURCE: World Bank Development Indicators Database

Development Indicators

Unfortunately, last year's Cyclone Sidr exacerbated the government's already inadequate capacity to govern and reversed much of the developmental progress which resulted from four years of economic growth. According to the most recent United Nations Development Program (UNDP) report, Bangladesh ranks 138th out of 174 countries in terms of GDP per capita; 93rd out of 108 on the human poverty index; and 140th out of 177 countries (for which data is available) on its annual Human Development Index (HDI) with a score of 0.547 on a scale from 0 to 1 (UNDP 2007). The HDI composites three aspects of human development including life expectancy; adult literacy and primary, secondary and tertiary school enrollment; and purchasing power parity (PPP) and income.⁹ Bangladesh has a relatively low GINI coefficient of 0.33 (with 0 corresponding to perfect equality and 1 to perfect inequality) because the majority of the population lives in poverty (World Bank 2007). Because 74 percent of the population lives in rural areas where access to health care is limited, the life expectancy is 64 years and 40.5 percent of the population is not expected to survive to the age of 40 according to the HPI-1¹⁰ UNDP index (UNDP 2007). Food security is a major problem for extremely

⁹ The UNDP explains: "The HDI provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and enrolment at the primary, secondary and tertiary level) and having a decent standard of living (measured by purchasing power parity, PPP, income). The HDI measures the average progress of a country in human development. The Human Poverty Index for developing countries (HPI-1), focuses on the proportion of people below a threshold level in the same dimensions of human development as the human development index - living a long and healthy life, having access to education, and a decent standard of living." (UNDP 2007 "Bangladesh: The Human Development Index: Going Beyond Income" http://hdrstats.undp.org/countries/country_fact_sheets/cty_fs_BGD.html)

¹⁰ "The HPI-1 measures severe deprivation in health by the proportion of people who are not expected to survive past age 40. Education is measured by the adult illiteracy rate. And a decent standard of living is measured by the unweighted average of people without access to an improved water source and the proportion of children under age 5 who are underweight for their age... By looking beyond income deprivation, the HPI-1 represents a multi-dimensional alternative to the \$1 a day (PPP US\$) poverty measure. The index is not in any sense a comprehensive measure of human development. It does not, for

poor citizens, for 48 percent of children aged 0-5 is underweight for their age, placing the country second to Nepal in this category (UNDP 2007). As a result of both cultural and religious mores, women continue to face discrimination socially and economically; Bangladesh ranks 93rd among 108 developing countries on the gender-related development index (GDI)¹¹ which seeks to quantify inequalities between men and income (UNDP 2007). These statistics illustrate the widespread poverty that has led to the ubiquity of both microfinance programs and child labor.

example, include important indicators such as gender or income inequality and more difficult to measure indicators like respect for human rights and political freedoms. What it does provide is a broadened prism for viewing human progress and the complex relationship between income and well-being.” (Ibid)

¹¹ “The gender-related development index (GDI), introduced in Human Development Report 1995, measures achievements in the same dimensions using the same indicators as the HDI but captures inequalities in achievement between women and men. It is simply the HDI adjusted downward for gender inequality. The greater the gender disparity in basic human development, the lower is a country's GDI relative to its HDI.” (Ibid)

Table 3.4: Development Indicators

Variable	2000	2003	2004	2005	2006
Aid (% of GNI)	2	3	2	2	
Aid per capita (current US\$)	9	10	10	9	
Adult Literacy Rate, Male , % (UNESCO)	50	50	50		
Adult Literacy Rate, Female, % (UNESCO)	31	31	31		
Adult Literacy Rate, Total, % (UNESCO)	41	41	41		
Improved sanitation facilities (% of population with access)	33		39		
Improved sanitation facilities, rural (% of rural pop. with access)	27		35		
Improved sanitation facilities, urban (% of urban pop. with access)	53		51		
Improved water source (% of population with access)	74		74		
Life expectancy at birth, total (years)	62			64	
Prevalence of undernourishment (% of population)		30	30		
Malnutrition prevalence, height for age (% of children under 5)	45		43		
Malnutrition prevalence, weight for age (% of children under 5)	48		48		
Mortality rate, under-5 (per 1,000)	92			73	
Poverty headcount ratio at \$1 a day (PPP) (% of population) ¹²	41				
Poverty headcount ratio at \$2 a day (PPP) (% of population)	84				
Rural population (% of total population)	77	76	75	75	74
Urban population (% of total)	23	24	25	25	26

Source: World Bank Development Indicators Database

Role of the Government: Financial Sector

One crucial element in analyzing both child labor and microfinance in Bangladesh is the corruption, weakness and ineffectiveness of the central government. Local government officials have meager resources with which to serve the needs of their constituents and few repercussions for inaction. As a consequence of its highly centralized bureaucratic structure, corruption, low budget and relative youth, Bangladesh

¹² “The head-count index of poverty measures the percentage of households with per person consumption below the poverty line. The head-count index does not measure the depth of poverty (that is, how far the poor are from the poverty line). It is nevertheless the most common measure used to indicate the extent of poverty in a population” (Khandker 1998, 56).

lacks the financial and legal infrastructure requisite for widespread participation in the formal financial sector. Commercial banks are limited to wealthy clients and businesses; the average citizen struggles to access formal financial services due to the absence of local branches in rural areas and a lack of education and information regarding credit. According to the World Bank, Bangladesh scores 2 (on a scale where 6 indicates higher levels of information) on the Credit Information Index which “measures the scope, access and quality of credit information available through public registries or private bureaus” (World Bank 2008). To illustrate the unavailability of credit information for Bangladeshi citizens in OECD countries the Credit Information Index averages 4.8 percent (World Bank 2008).

Furthermore, the fact that four state-owned banks run the Bangladeshi banking system and control approximately 50 percent of assets within the country demonstrates the exclusion of poor citizens in the formal financial sector (Credit and Development Forum 2006, 3). NGOs have filled the vacuum created by poor governance and provide financial and social services including credit and savings, health care and education. Figure 5 highlights the exorbitant costs of starting a legal business in the formal marketplace as well as the lack of development of the Bangladeshi financial sector and unavailability of credit information for potential borrowers.

Table 3.5: Financial Sector Indicators

Variable	2000	2003	2004	2005	2006
Cost of business start-up procedures (% of GNI per capita)	.	122	106	94	88
CPIA financial sector rating (1=low to 6=high)	.	.	.	3	.
Credit information availability index (0=less info to 6=more info)	2

SOURCE: World Bank Development Indicators Database

Role of the Government: Microfinance Programs and Regulation

Though they may remain excluded from the formal economy, most of the poor people in Bangladesh now have access to microfinance programs as a result of its high success rates and volume.¹³ In fact, microfinance programs produced such promising results that the Bangladeshi government adopted it as part of its rural development strategy. In 1982, the government created the Bangladesh Rural Development Board (BRDB) which set up cooperatives in poor, rural areas that provided men and women with skills and leadership training, savings mobilization, and access to credit (Khandker 1998, 18). The Canadian International Development Agency donated funds to improve and expand the government's existing rural development project that enabled the creation of the Rural Development Project-12 (RD-12) to provide microcredit to the rural poor (Khandker 1998, 18). Today government microcredit programs serve approximately 1 million borrowers at a flat interest rate of 11 percent though the impact and effectiveness of these initiatives is ambiguous due to the reliability of available statistics (World Bank 2006, 21). It is interesting that the government has invested so many financial resources in the provision of microcredit instead of working to make the formal financial sector

¹³ For more information on the importance of integrating the informal sector into the formal economy, see chapter one.

more inclusive, but the Bangladeshi government has never been known for its capacity for reform and regulation.

Despite its breadth and global esteem, the microfinance industry in Bangladesh was not regulated until 2006 when the government passed the Micro Credit Regulatory Authority Act. The Act established the Micro Credit Regulatory Authority to monitor and supervise both lending and savings institutions created specifically for the poor (Microfinance Gateway 2008). As of 2007, organizations offering microfinance must apply for official government certification and will then be subject to the standards established by the Regulatory Authority. The Act requires MFIs to fully disclose and report all financial activity, to subject themselves to internal audits and inspections, to employ directors who meet federal criteria and to establish to create a reserve fund (Microfinance Gateway 2008). It remains to be seen whether or not the government will, in fact, enforce the stipulations put forth in the Micro Credit Regulatory Authority Act. The expansiveness of microfinance, inadequate federal funding and a lack of manpower pose major obstacles to its implementation though hopefully regulation of the microfinance industry will not mimic that of child labor in Bangladesh.

Role of the Government: Regulating Child Labor

In spite of the over 25 laws aimed at protecting working children, NGOs are ultimately responsible for monitoring employers, providing working children with access to formal and informal education, and ensuring that children do not work in hazardous conditions or forced labor. The Ministry of Labor and Employment is the organ responsible for monitoring and penalizing violations against the rights of child laborers, but it is comprised of only 110 inspectors to monitor about 180,000 *registered* factories

and establishments (U.S. State Department 2001). This lack of manpower means that “child labor laws are seldom enforced outside of the [heavily publicized] garment export industry,” for according to one ministry official in Dhaka, “There have been no prosecutions for violations of child labor laws” (U.S. State Department 2001).

Bangladesh is a signatory to the ILO Conventions on the Worst Forms of Child Labor (No. 182), Forced Labor (No. 29), and Abolition of Forced Labor (No. 105) as well as the UN Convention on the Rights of the Child. Laws setting the minimum age for employment vary by sector.

One of the most important and oldest domestic laws regulating child labor in Bangladesh is the Employment of Children Act (1938) which prohibits children under the age of 12 from working in workshops or factories where hazardous work is performed. The Employment of Children Act set a dangerous precedent by exempting family-owned and family-run workshops that do not use outside labor from its scope (IPEC/ILO). Even though they are not participating in the wage labor market, children who work in the family business are still detracted from going to school. Another landmark law, the Factory Act (1965) limits children’s work to 5 hours per day between the hours of 7 AM and 7 PM. On paper, the Factory Act institutionalized the capacity of children to work *and* attend school; however, the government lacks the manpower, funding and concern to enforce these laws.

Role of the Government: Public Education

Another area in which the government has failed to fulfill its legislative promises is education. Since the 1990s, the Bangladeshi government has launched a number of initiatives to encourage parents to send their children to school and achieve universal primary education by the year 2015. Despite progress in eliminating gender disparities and increasing primary school enrollment, about 30 percent of Bangladeshi children never receive a full primary education because 6 percent of children never enter into the primary education system and 25 percent drop out (USAID 2007). Moreover, the Bangladeshi government spends only 2 percent of total GDP and 14 percent of total government expenditure on education (World Bank Development Indicators 2005), the lowest rate in South Asia, and 96 percent of this meager amount goes to teachers' salaries ("Report on Primary Education in Bangladesh" 2005, 11).

The Bangladeshi education system also suffers from inequitable access between regions, rural and urban areas, gender and household income levels ("Report on Primary Education in Bangladesh 2005, 5). Even though primary government schools are allegedly free for all citizens, uniform and supply costs can reach 1,000 taka (US \$14) annually ("Report on Primary Education in Bangladesh" 2005, 11). Consequently, children from poor households or with illiterate parents are 24 percent less likely to attend school than those from wealthier households with educated parents ("Report on Primary Education in Bangladesh" 2005, 11). Even in instances where children can access schools, they are generally of poor quality and lack standardization, for there are many types of education including formal, non-formal, English-medium, and Bangla-medium. According to the World Bank, four out of five Bangladeshi children who completed five years of primary education failed to attain a minimum learning level

(Greaney 1996) and only 44 percent of children continue to enroll in secondary school (World Bank Development Indicators 2005). NGOs have filled the vacuum created by the government's failure to invest in primary education by establishing thousands of schools throughout the country. The government now relies too heavily upon NGOs to provide primary education, which is actually of a much higher quality, and has little impetus to direct more federal resources towards education without which long-term, sustainable development will be impossible ("Report on Primary Education in Bangladesh" 2005).

Table 3.6: Education Indicators

Variable	2000	2003	2004	2005
Average attendance rate (% of those enrolled in school) ¹⁴			60	
Primary completion rate, total (% of relevant age group)	84	73	76	..
Primary school dropout rate, total (% of enrollment)			23.6	
Primary education, duration (years)	5	5	5	5
Average time it takes students to complete primary education (# of years) ¹⁵			6.6	
Public spending on education, total (% of GDP)	2	2	2	2
Public spending on education, total (% of government expenditure)	15	15	15	14
School enrollment, primary (% gross)	109	106	109	..
School enrollment, primary (% net)	89	93	94	..
School enrollment, primary, female (% gross)	109	107	111	..
School enrollment, primary, female (% net)	90	95	96	..
School enrollment, primary, male (% gross)	109	105	107	..
School enrollment, primary, male (% net)	89	92	93	..
School enrollment, secondary (% net)	47	48	44	..

SOURCE: World Bank Development Indicators Database

Microfinance Overview

¹⁴ Campaign for Popular Education (CAMPE) "Quality with Equity: The Primary Education Campaign in Bangladesh," 2004.

¹⁵ Ibid.

One consequence of this endemic poverty and inadequate governance is the pervasiveness of microfinance programs in Bangladesh. With more MFIs than any other country, the most comprehensive analyses of the effect of microfinance on poverty alleviation and livelihood originate from Bangladesh. According to a 2005 World Bank report, microcredit now serves 24.6 million clients (Credit and Development Forum 2006), or approximately 43 percent of all Bangladeshi households, and about 70 percent of poor households (World Bank 2006, iii). NGOs serve 60 percent of microfinance clients, or 16.4 million borrowers (Helms 2006, 48), and generally charge a flat interest rate of 11-15 percent (S.M. Rahman 2000, 4). Moreover, the four dominant lending institutions, Grameen Bank, BRAC, ASA, and Proshika, account for 86.6 percent of all borrowers who have amassed \$800 million in outstanding loans and approximately \$300 million in savings (World Bank 2006, 18). Microcredit loans average 2500 taka (about \$35) (S.M. Rahman 2000, 4). Member savings provide 30 percent of the funds for microcredit in Bangladesh and the average loan recovery rate overall is 93 percent (Credit and Development Forum 2006, 8). Though the majority of funding comes from members' savings and interest, domestic organizations, primarily PKSF, provide supplementary financial support. Grants from foreign donors used to comprise a much larger portion of the funds used for microfinance in Bangladesh, however, as the industry has developed, a greater number of MFIs have become sustainable eliminating much of the demand for external financing (Credit and Development Forum 2006, 16). Today, 80 percent of funding comes from Bangladesh while only 20 percent comes from external donors (S.M. Rahman 2000, 9).

Because funding for MFIs has diversified over the past decade, the microcredit market in Bangladesh has become more competitive which has lowered interest rates, expanded the number and scope of financial services available and allowed borrowers to be more selective in choosing a lender (World Bank 2006, 21). However, as a result of the rapid and massive expansion of the microfinance industry over the past two decades, Bangladeshi MFIs have shifted their focus from outreach towards becoming financially sustainable. In order to attract more donor investments, expand their operations and achieve economies of scale to minimize their losses, MFIs work hard to expand their loan distribution. According to numerous scholars, the quest of Bangladeshi MFIs and NGOs to achieve self-sustainability has come at the expense of monitoring and transparency which are crucial to ensuring the financial success of borrowers' enterprises (Aminur Rahman 1998, 67). Organizations such as ASA have managed to achieve financial sustainability without compromising on the quality of the financial services provided. Though there are over more than 1200 microfinance NGOs in Bangladesh today, 200 of which have large microcredit programs and 721 of which are classified as MFIs, the four most prominent microfinance organizations in Bangladesh are Grameen Bank, BRAC, the Palli-Karma Sahayek Foundation (PKSF), ASA and Proshika (Credit and Development Forum 2006, 5).¹⁶

Grameen Bank

In 1976, economics professor Muhammad Yunus launched an experimental project to lend small amounts of his own money to poor women in the southern region of Chittagong. Seven years later, the Bangladeshi government officially recognized

¹⁶ See appendix 1 for more information on PKSF, ASA, and Proshika.

Grameen Bank as a specialized “Bank for the Poor,”¹⁷ whose collateral-free, group-based lending model has been replicated in more than 100 countries around the world. Yunus has been so successful in establishing and replicating microfinance worldwide that he and his clients were jointly awarded in the Nobel Peace Prize in 2006. Based on the premise that credit is a basic human right, the Grameen Bank is a minimalist MFI created to provide small-scale loans to impoverished, rural women to utilize their entrepreneurial talent to start or expand their existing income-generating activities. Grameen offers a range of financial services including basic, flexible, housing, microenterprise, and education loans; savings programs for members and non-members; pension schemes; and life and loan insurance policies. Since its inception, the Grameen Bank has disbursed over \$6 billion USD in loans to nearly 6 million borrowers, 96 percent of whom are women, while achieving a repayment rate of 98 percent. As of January 2007, Grameen had 122,767 centers in 75,359 villages (Grameen Bank 2007, 1). Grameen Bank borrowers own 94 percent of the bank while the government owns the other 6 percent. The bank has made a profit every year except for 1983, 1991, and 1992, and in 2005, earned a profit of \$15.21 million (Grameen Bank 2007, 4).

What distinguishes Grameen Bank from traditional banks is not only its target clientele, rural females who own less than .5 an acre of land, but also its is its group-lending model that uses “social collateral,” i.e. peer pressure and reputation in lieu of assets as collateral. In order for women to receive a loan from Grameen, they must form small homogenous groups of 5-8 members. One member of the group first receives a loan and must demonstrate the capacity to repay it before other members can be eligible to

¹⁷ Muhammad Yunus coined the term “Bank for the Poor.”

borrow from the bank. Every week, a branch manager visits the borrowers' village and collects loan installments in cash. Each borrower has a ledger in which the area manager records her outstanding loans, weekly installments and savings. The crux of Grameen's model is a firm belief in independence and self-sufficiency. As Professor Yunus articulates, "All the ingredients for ending poverty of a person always comes neatly packaged with the person himself" (Grameen Bank 2007, 2). In response to criticism that microfinance does not reach the poorest, in July 2002, Muhammad Yunus launched an unprecedented project known as the Struggling Members' Program that redefined the lending process by distributing collateral and interest-free loans to beggars. As of February 2007, this unique program has reached over 80,000 of the most vulnerable Bangladeshis who attain loans averaging \$2 US; nearly 60 percent of these loans have been repaid thus far. The success of the Grameen Bank enabled Professor Yunus to expand his own entrepreneurial activities to form the Grameen Network comprised of sixteen sister companies including Grameen Telecom, Knitwear, Education, Kalyan (well-being) and Trust.

BRAC

In 1972, a year after receiving their independence from Pakistan, Fazel Abed founded the Bangladesh Rural Advancement Committee (BRAC) in order to aid victims of the great famine of 1970 and families displaced by the 1971 War of Liberation. Abed's pragmatism and concern for his fellow citizens led to the BRAC's rapid expansion for it is now the largest NGO in Bangladesh and offers myriad health, education, legal and social services. In 1976, BRAC began a microcredit program as part of its holistic approach to alleviating poverty. Providing the poor with access to credit has never been

the primary objective of BRAC, but it has been an integral tool to improve household welfare. Since it began its microfinance program, BRAC has loaned over \$4 billion and currently has 6 million borrowers, 98 percent of whom are women (Morduch and Haley 2002, 39). Like Grameen Bank, BRAC's microcredit program has 170,000 Village Organizations throughout rural areas in order to collect loan repayments and meet to discuss pertinent social and business issues. BRAC's microfinance program offers more than simply loans, but also entrepreneurial and financial training, the formation of cooperatives, and integrated informal education programs.

Challenging the common perception that microfinance excludes the poorest, BRAC established the Income Generation for Vulnerable Groups Development (IGVGD) Program together with the government of Bangladesh and the World Food Program. IGVGD targets the poorest rural women and couples the provision of grain with business training and eventually microcredit. Over the past decade, 75 percent of these women are no longer considered to be living in absolute poverty and now participate in BRAC's microfinance programs (Morduch and Haley 2002, 39). In 2002, BRAC began a new program called "Challenging the Frontiers of Poverty Reduction: Targeting the Ultra Poor" (CFPR-TUP) which seeks to address the unique needs of the poorest of the poor by providing them with business training, asset transfers, group counseling and support and essential health care with the hope that they can eventually graduate to participating in mainstream microfinance programs. The CFPR-TUP initiative highlights the importance of targeting a particular group of poor clients and designing an institutional structure that provides the social and financial services they demand.

Target Clientele

In order to maximize the effectiveness of microcredit for poor borrowers, organizations must establish a target group of participants and then tailor their financial services around its needs. In Bangladesh, the primary target clientele for microcredit are rural inhabitants who own less than half an acre of cultivatable land (Grameen Bank and BRAC). According to Shahidur Khandker, 79 percent of households in Grameen Bank villages, 83 percent in BRAC villages and 85 percent in RD-12 villages met the eligibility criterion which suggests that these organizations adhere to their own rules in this regard (Khandker 1998, 40). Moreover, 55 percent of Grameen, 65 percent of BRAC and 58 percent of RD-12 borrowers came from poorer, landless households which suggests that these programs are not only reaching moderately poor borrowers (Khandker 1998, 40). Despite exponential growth over the past two decades, however, only 45 percent of eligible households in program villages participate in microfinance programs for a number of reasons¹⁸ (Khandker 1998, 39).

Microfinance programs in Bangladesh primarily target women because studies have demonstrated that women use loans more responsibly and the entire household benefits more than when men receive credit (Pitt and Khandker 1998). As critics are quick to point out, the ultra poor are not the predominant targets of microfinance, though some organizations such as Grameen Bank and BRAC have implemented the Struggling Members' Program and the IGVGD Programs respectively. Still, according to Khandker, approximately 83 percent of Grameen Bank borrowers were moderately poor and 33

¹⁸ Registration fees, group meeting and training session attendance; discrimination against the poorest by current borrowers who see them as too risky; and self-exclusion can prevent potential borrowers from participating in microfinance programs (Develtere and Huybrechts 2005, 174).

percent were extremely poor before participating in its programs; these numbers decreased to 62 and 10 percent respectively after five years (Khandker 1998, 56).

The divergent institutional structures and objectives of microfinance providers in Bangladesh dictate their target clientele. Some programs, such as BRAC, combine microcredit with business training, cooperatives, education and health initiatives while minimalist organizations such as the Grameen Bank and ASA emphasize self-reliance and individual entrepreneurial capacity and do not buttress their financial services with social programs. These different institutional aims can have a large impact on the effectiveness of microfinance programs, for the “combined impact of credit and noncredit interventions on self-employment profits” is 50 percent higher than that of only noncredit interventions (Morduch 1998, 24). One of the most pertinent and effective programs is the Non-Formal Primary School (NFPE) program started by BRAC that enables poor borrowers (and non-borrowers) children to attend informal school. Clearly when microfinance programs provide services tailored to their clients' needs that exceed the mere provision of credit, they can have a larger impact on stabilizing household income levels and enabling children to receive an education in lieu of working.

Child Labor Overview

Despite media attention and legislation¹⁹ in the United States and around the world, millions of children continue to work in Bangladesh whether in tandem with or in lieu of attending school. The Bangladesh Multiple Indicator Cluster Survey (MICS) conducted by the Bangladesh Bureau of Statistics (BBS) and funded by UNICEF

¹⁹ U.S. Senator Tom Harkin attempted to pass a bill known as the Child Labor Deterrence Act of 1993 that would have banned the importation of any goods that use child labor in any stage of production.

estimates that 12.8 percent of children between the ages of 5 and 14 are engaged in child labor (MICS 2006, 101). In its 2003 Child Labor Survey, the BBS distinguished between two categorizations of working children that garner disparate results. The BBS' *extended* definition includes children over the age of ten who are engaged in all income-generating activities both paid and unpaid, inside and outside of the household while the *usual* definition excludes work inside a child's household (Salmon 2005, 34). Utilizing the extended definition captures the economic contributions of girls which often go underestimated because their primary economic activity is domestic housework. The BBS estimates that 5.4 million, or 15 percent of children between the ages of 5 and 14, were economically active according to the usual definition while about 7.9 million, or 21 percent, were categorized as such under the extended definition (Salmon 2005, 35). Therefore, children comprise anywhere between 9 and 11 percent of the total labor force in Bangladesh depending on the definition employed by statisticians (Salmon 2005, 35). The BBS survey approximates that, on average, one child works in every Bangladeshi household (Tariquzzaman and Kaiser 2008, 2) earning an average income of 43 takas (\$0.62) a day (Salmon 2005, 39). Moreover, 1.3 million children are involved in hazardous work (Tariquzzaman and Kaiser 2008, 2) and around 5 million children, or around 12 percent of children 5-17, are working and not going to school at all (BBS 2006).

Figure 3.7: Child Labor Indicators

Variable	2003
Child employment in agriculture (% of economically active children ages 7-14)	62
Child employment in manufacturing (% of economically active children ages 7-14)	13
Child employment in services (% of economically active children ages 7-14)	23
Economically active children, female (% of female children ages 7-14)	14
Economically active children, male (% of male children ages 7-14)	21
Economically active children, study and work (% of economically active children, ages 7-14)	37
Economically active children, total (% of children ages 7-14)	18
Economically active children, work only (% of economically active children, ages 7-14)	63

SOURCE: World Bank Development Indicators Database from Bangladesh Bureau of Statistics' National Child Labor Survey 2003

Poverty is one cause of Child Labor

Though extreme poverty is not the *only* reason that children work, it is the most pervasive trend in the global and domestic statistics of child labor. As elsewhere where child labor is endemic, the economic contributions of children in Bangladesh are often crucial to the survival of their household. In order to analyze the relationship between poverty and child labor, the author will return to the economic model posited by Kaushik Basu and Pham Van (1998) in chapter two. The basic premise behind this paradigm is that parents send their children to work because they cannot forego the wages lost in the short-run by sending their child to school in exchange for the long-run returns to education in the form of higher wages. Basu and Van refer to this trade-off as the Luxury Axiom in which children work because non-work (i.e. education and leisure) is a luxury their parents cannot afford. Empirical data from Bangladesh supports the validity of the Luxury Axiom: children from the poorest households in Bangladesh are much more

likely to work than those from better-off households (Delap 2001; Salmon 2005; Amin, Quayes, and Rives 2004; Save the Children, UK; ILO).

Using data collected by the BBS in the National Labor Force Survey, economist Claire Salmon (2005) found that children, especially girls, are much more likely to work in households where all of the adults work. Salmon finds that 50 percent of all child laborers live in a household where all of the adults work, and in the poorest households, children contribute as much as 50 percent of total household income (Salmon 2005, 46). Consequently, Salmon concludes that children who work in Bangladesh often do so because they are the “last economic resource of the household” (Salmon 2005, 4). The fact that household income level and the duration of work are inversely correlated demonstrates that parents will only send their children to work when entangled in a desperate situation (Salmon 2005, 37).

Because poverty and child labor are significantly correlated, poverty-reduction programs such as microfinance can potentially diminish the likelihood that children will work by raising household consumption levels. As leaders of the World Bank team responsible for the first and most rigorous evaluation of microfinance in Bangladesh, economists Mark Pitt and Shahidur Khandker found that microfinance programs (BRAC, Grameen Bank, and the government-funded RD-12 program) increased annual household consumption expenditure through self-employment (1998). Khandker and Pitt provide the most conclusive evidence that providing women with access to credit has a greater impact on a household’s welfare than male borrowers in Bangladesh. In their evaluation of BRAC, Grameen, and RD-12, Pitt and Khandker find that for every 100 additional

taka borrowed by women, annual household consumption expenditure increases 18 taka compared with 11 taka for men (Pitt and Khandker 1998, 958).

Scholars provide a number of explanations for this divergence. One observation is that males consume more leisure time with increases in household expenditure in a patriarchal society where women are solely responsible for household tasks (Pitt and Khandker 1998, 984). Moreover, *purdah* and a labor market divided by gender effectively eliminate the ability of women to participate in the wage labor market. Therefore women benefit more from capital to start their own business (generally within the confines of their home) because men participate in the wage labor market. Because women are responsible for domestic tasks and the welfare of their family in Bangladesh, one can also assume that they are more likely than their male counterparts to spend their earnings on their children and extended family. With the ability to consume beyond their immediate means by participating in a microfinance program, sending a child to school is no longer a luxury that a family cannot afford, and children may be less likely to work.

Luxury Axiom

Data from Bangladesh supports the underlying premise of the Luxury Axiom that work and non-work, i.e. leisure and education, are substitutes. Theoretically, working and attending school are not mutually exclusive for Bangladeshi children. It is entirely plausible for children to attend school *and* work because public primary schools are open only 120 days per year and there are only 3-4 hours of class daily (Ravallion and Wodon 2000, 160). Therefore a child who works 20 hours per week *could* attend school everyday, but unfortunately many do not: only 37 percent of “economically active” children aged 7-14 work *and* attend school while 63 percent of this same group *only*

works (World Bank Development Indicators Database 2003). The Luxury Axiom provides an economic explanation for the high incidence of child labor, however, it cannot be viewed in a vacuum. As previously mentioned in this chapter, limited educational opportunities leave many children from poor households with few viable alternatives to work. Moreover, children from poor families in Bangladesh often find education to be irrelevant because they are more concerned with acquiring practical skills necessary to generate more income. Finding little value in school is not a pervasive cultural trend, for both children and parents understand the importance of education and “failures to send children to school could only be justified in terms of extreme poverty” (Tariquzzaman and Kaiser 2008, 2). In fact, school attendance and work seem to be substitutes for poor children in Bangladesh.

According to 1995-1996 Household Expenditure Survey conducted by the BBS, 15 percent of children enrolled in school gave child labor, defined as “help at work,” “farm work,” and “help in the family business”, as the primary reason for their absences (Ravallion and Wodon 2000, 160). In an interview with children at an informal school for child laborers operated by RDRS in Kurigram, one of the country’s poorest *upazilas*,²⁰ a group of young boys explained that about one a week they were unable to attend school because of their heavy workload.²¹ Save the Children UK and several local advocacy organizations persuaded employers to abide by a code of conduct that ensures that guarantees working children one and a half hours for school and freedom from hazardous working conditions. Though these boys both work *and* attend school, such a short period

²⁰ Districts are divided into subdistricts known as *upazilas* which are the lowest administrative level in Bangladesh.

²¹ Interview with child laborers in Kurigram at RDRS, July 2007. See Appendix 4 for more interviews with child laborers.

of instruction is insufficient to achieve a minimum level of education, but is more beneficial than nothing. This experience highlights the difficulty in analyzing the relationship between child labor and education in Bangladesh. One cannot simply compare school enrollment rates and data on child labor because it fails to capture the variance in standards, attendance and the substitutability of work and school all of which have large implications in dictating appropriate policies to attack the problem.

Economists Martin Ravallion and Quentin Wodon (2000) attempted to determine whether or not school and work are substitutes in poor Bangladeshi households by analyzing the relationship between school enrollment subsidies and child labor. In 1995-1996 the government established the Food for Education (FFE) program which provided 2.2 million children with food rations at school contingent upon achieving an attendance rate of at least 85 percent of classes per month (Ravallion and Wodon 2000, 162). In their evaluation of the FFE program, Ravallion and Wodon observe that the stipend increased school attendance more than it decreased child labor and was divided by gender; for boys, “the reduction in the incidence of child labor...represents about one quarter of the increase in their school enrollment rate,” while for girls, child labor was reduced by one eighth (Ravallion and Wodon 2000, 173). These findings support the hypothesis that school attendance and leisure time are luxuries that extremely poor households cannot afford in Bangladesh. The authors conclude, “Parents are clearly substituting other uses of their children’s time so as to secure the current income gain from access to the program with modest impact on earning from their children’s work” (Ravallion and Wodon 2000, 173). Therefore, programs that subsidize school attendance in Bangladesh may not diminish the likelihood that children from extremely poor households will work

either because parents want to maximize the economic benefit of the stipend and continue to send their child to work or because of the nature of the relationship between parents and children in household labor market decisions.

Microcredit programs may be more effective than stipends in increasing the likelihood that children will go to school, especially those that encourage borrowers to do so. Pitt and Khandker find a significant positive correlation between credit and the probability that girls will enroll in school for Grameen Bank participants, though not for BRAC or the RD-12 program (there is no particular explanation for this divergence as Grameen does not provide the children of its borrowers with access to informal schooling) (Pitt and Khandker 1998, 986). The authors also find that the sons of female participants in both Grameen and RD-12 programs are more likely to attend school than those of non-participants (Pitt and Khandker 1998, 986). Morduch also provides evidence to support this claim: his data demonstrates that 62 percent of the school-age sons of Grameen Bank borrowers are enrolled in school versus 34 percent of the sons of eligible households that do not borrow. Providing women with credit significantly increased boys' school enrollment, but had a negligible impact on that of girls according to Morduch's study (Morduch 1998). Girls were no more likely to go to school because daughters and mothers are substitutes within the labor supply of a household in Bangladesh. The relationship between parents and children in the labor market is extremely important in determining the likelihood that children will attend school.

Substitution Axiom

The other tenet of Basu and Van's econometric model of child labor is the Substitution Axiom which assumes that adults and children are substitutes in the labor market. Studies conducted in Bangladesh do not support this hypothetical relationship. Economists have found that adults and children are not appropriate substitutes in the labor market. First, societal perceptions regarding types of work unsuitable for adults renders children unlikely substitutes and dictates their income-generating activities according to scholar Emily Delap (2001). Low-status jobs considered to be explicitly for children include: working as the playmate of a rich employer's children; cleaning tables, lighting stoves, serving water, sweeping and sleeping inside as a protector in small restaurants and tea stalls; cleaning equipment, serving tea, snacks and cigarettes, helping the mechanic and working in "hard-to-reach" spots in garages; stuffing cotton wool inside dolls; washing vegetables in grocery shops; searching through trash; breaking bricks for cement, and many other unskilled, "dirty" tasks that adult workers view as beneath them (Tariquzzaman and Kaiser 2008, 27).

Second, because the Bangladeshi labor market is heavily divided upon gender lines, fathers and sons may be substitutes or complements in household labor decisions while mothers and daughters are complements according to economists Shahina Amin, Shakil Quayes and Janet M. Rives (Amin, Quayes and Rives 2004, 30). Boys in rural areas are substitutes for their father's labor, though older rural boys are more likely to be complements because they work alongside in the field with their father. In the case of mothers, even if they contribute enough income to fulfill the needs of their families, one reason children may continue to work are concerns about boys' idleness and girls' safety (Amin, Quayes and Rives 2004, 30). Amin and his colleagues posit that mothers and

children are complements in market work outside of the household while mothers and daughters are substitutes for domestic work (Amin, Quays and Rives 2004). As a result of a inadequate child care and the vulnerability of females in a patriarchal society, mothers often take their daughters to work with them outside the household or encourage their involvement in “market work at home” that may teach them valuable skills, but still detracts from their opportunity to attend school (Amin, Quays and Rives 2004, 30). When mothers work, their daughters bear a much heavier burden than their sons because they absorb the bulk of domestic responsibilities; consequently, “The relationship between mother’s wage and the rate of a girl’s participation in household work could be in the form of an inverted U” (Amin, Quays and Rives 2004, 27). Though the more mothers work, the more girls will have to do housework, there is some unknown threshold in household income level at which point a mother’s wage eliminates the need for daughters to work, presumably because the household can hire someone else to do the housework. Regardless of this threshold, girls may be more susceptible to increased workloads when their mothers work in either their own business or the wage labor market.

Impact of Gender Inequality on Child Labor

As a result of cultural perceptions of gender and in accordance with global patterns in child labor (Fares and Raju 2007), boys in Bangladesh are much more likely to be work in the wage labor market than girls: 17.5 percent of boys aged 5 to 14 work outside the home while only 8.1 percent of girls within the same age group work (MICS 2006, 101). Just as in the adult labor market, children’s work is divided along both gender and urban-rural lines. For girls, the Muslim practice of *pardah*, or female seclusion,

begins at the onset of puberty, usually around age 12. This cultural more effectively eliminates the female wage market for both adult and child labor and causes women and girls to work primarily indoors. In urban areas, girls work primarily in factories or as domestic servants while in rural areas, girls work primarily as domestic servants or rolling *bidi*, a small cigarette. Consequently, scholars and governments grossly underestimate the contribution of female children to household income, for quantitative studies on child labor do not capture the myriad unpaid domestic activities conducted by girls (Amin, Quays, and Rives 2004, 20). Because Bangladeshi society views housework as a task suitable only for women, girls work primarily in the domestic sphere and are likely to work longer hours for smaller or no pay. Though they may not threaten their safety or well-being like numerous jobs outside of the home, domestic activities detract from a girl's ability to go to school and may be just as detrimental to her development as participation in the labor wage market.

Families often see domestic work as an opportunity for their daughters to acquire the skills necessary to serve their husband's needs. For many Bangladeshi girls, early marriage is a fact of life. According to the MICS, 33.1 percent of women between the ages of 15 and 49 were married before the age of 15 (MICS 2006, 286). Girls from the most destitute households are more likely to be married early because the dowries for young brides are much lower than their wealthier counterparts. Furthermore, in this patriarchal society, boys bear a more obvious burden to supporting their families and are much more likely to work outside of the home and less likely to attend school than their female counterparts. In urban areas, boys commonly work as shop assistants, street vendors, factory assistants, rickshaw pullers, day laborers, and servants, or engage in

tasks such as crushing stones and collecting firewood (Amin, Quayes, and Rives 2004, 877). Boys are much more likely to work in hazardous or dangerous conditions that deprive them of their right to health and livelihood.

Cultural Factors

Regardless of sex, poor Bangladeshi parents generally view children as *dangor*, or capable of working, from the age of 12 onward and believe that can and should acquire valuable skills for better employment in the future (Save the Children UK 2005, 4). Employers also share the belief that children can benefit from work. In 2007, BRAC and Save the Children UK conducted a study evaluating the perceptions of employers who utilize child labor. Overall, they found that employers believe that child labor is necessary and inevitable. Whether in the informal or formal sector, employers generally believe that they are playing a vital and altruistic role in providing poor children with income to survive in the short term and training that will enable them to acquire skills for future employment. This is especially true in the case of domestic servitude, for wealthy households often view employing young girls as servants as a noble and honorable deed. In Dhaka, for instance, the most prominent families have three or four young girls working as servants who prepare meals, wash their clothes, serve tea, tidy the house, and do the majority of household tasks in exchange for food and a place to sleep on the kitchen floor. Though some of these young girls are orphans, many come from rural areas and send what little, if any, earnings home to their villages. In rare cases, employers may pay for their domestic servants to receive an education but generally they do not see a need for them to attend school.

Though education is a luxury that extremely poor households cannot afford, poverty alone insufficiently explains the high prevalence of child labor in Bangladesh. Developmental scholar Emily Delap (2001) underscores the fact that child labor is not a purely economic phenomenon, for “economic and cultural forces cannot be viewed in isolation, as the two often interact” (Delap 2001, 17). In her study of a Dhaka slum, Delap found that many children work even if they are not the “last economic resource of the household,” (Salmon 2005) as a result of gender norms dictating that boys should help financially support their family and girls should be secluded due to *purdah* (Delap 2001, 16). Domestic security is another factor in the likelihood that children will work. Children may find the workplace to be safer than their homes in households with a single parent or guardian and inadequate childcare, where domestic violence occurs or where the family moves frequently. Domestic insecurity is more pronounced in urban areas like Dhaka where 25 percent of residents live in slums. In these extremely poor and dangerous areas, both parents and children are concerned about idleness. Poor children often find themselves unoccupied in an environment permeated by violence, drugs and other idle children as limited access to schooling leaves them with few, if any, alternatives to work.

Unfortunately, many of the jobs exclusively delineated to children endanger or harm the health and well-being of participating children. The majority of these jobs occur in the informal economy outside of the scope of independent and government monitoring agencies and advocacy groups making children more apt to work in hazardous conditions. With greater ease of exploitation and fewer legal parameters for employers, 93.3 percent of child labor in Bangladesh takes place in the informal sector (ILO 2004).

Like many of its low-income counterparts, Bangladesh lacks the financial and legal infrastructure requisite of a well-developed and inclusive formal economy which means that one finds the majority of economic activity in the informal sector. The existence of such a large informal economy provides children with more opportunities for employment.

Impact of Labor Market Composition on Child Labor

The demographic composition of Bangladesh facilitates the participation of children in the labor market. First, the extremely high population density (1,109 people per square km) (World Bank Development Indicators 2007) renders the demand for labor extreme elastic; the large excess supply of labor in the Bangladeshi economy means that wages are low for adults, and even lower for children. The absence of a federal minimum wage, high demand for unskilled labor and incapacity of the market to absorb adults in the formal sector exacerbate household and cultural attributes that drive children to work. In rural areas, the population is growing at 4 percent annually exacerbating scarcity in extremely poor households and rendering children's wages a necessity for survival in some instances (World Bank Development Indicators 2007). Second, 35 percent of the Bangladeshi population is 14 years old or younger making children a vital economic resource in a country where roughly half of the population lives below the poverty line (World Bank Development Indicators 2007). Scholars estimate that children comprised 9 to 11 percent of the total labor force in 2000 depending on the definition of child labor (Salmon 2005, 33).

Third, legal barriers to establishing and/or working in a formal business also contribute to the dominance of the informal economy. Bangladesh ranks 107 out of 178

economies on the Ease of Doing Business scale created by the World Bank and 92nd on the Ease of Starting a Business Index (World Bank 2008). As a result of these factors, “approximately 80 percent of women and 70 percent of men work in the informal economy,” according to estimates put forth by the ILO (USAID 2005, 2). The informal economy lacks legal procedures such as paperwork, identification and property rights which inhibits the capacity of workers to access financial services that would enable them to save, borrow, or invest and leaves its participants extremely vulnerable to fluctuations in household income.

Table 3.8: Population and Labor Force Statistics

Variable	2000	2003	2004	2005	2006
Labor force participation rate, female (% of female population ages 15-64)	57	57	55	55	55
Labor force participation rate, male (% of male population ages 15-64)	88	88	88	88	88
Labor force participation rate, total (% of total population ages 15-64)	73	73	72	72	72
Labor force, female (% of total labor force)	38	38	37	37	37
Population ages 0-14 (% of total)	38	36	36	35	35
Population ages 15-64 (% of total)	59	60	61	61	61
Population ages 65 and above (% of total)	3	4	4	4	4
Population density (people per sq. km)	990	1050	1069	1090	1109
Population growth (annual %)	2	2	2	2	2
Rural population (% of total population)	77	76	75	75	74
Unemployment, total (% of total labor force)	3	4			
Urban population (% of total)	23	24	25	25	26

SOURCE: World Bank Development Indicators Database 2007

Income Volatility

Seasonal fluctuations, natural disasters, and lack of savings cause income levels to fluctuate widely in extremely poor households in Bangladesh (Delap 2001; Salmon 2005; Save the Children UK 2005). Child labor comes from families that live “hand-to-mouth”, households that cannot afford to save even five taka (\$0.07) a week. In the rural sector where agriculture is the primary economic sector, adverse income shocks such as crop failures, floods, river erosion, droughts and lower market prices can unexpectedly and drastically diminish the income and consumption levels of poor households. During the monsoon season, flooding destroys crops families rely upon for household consumption and employment. Because there is no demand for agricultural labor and few job alternatives, monsoon season is known as *monga*, or joblessness in many rural areas. Unable to cope with these negative externalities, families will either increase the non-agricultural income-generating activities of their children or send their children to the city to find employment. In such a circumstance, the survival of both the child and his family may depend on his economic contribution to household income. One working child aptly describes the reality of this desperate time: “*Kam nai, khoa nai*,” translated as “no work, no food.” These observations support the findings of economist Claire Salmon (2005) that children who work in Bangladesh do so because they may be the “last economic resource of the household” when poor families experience negative, exogenous income shocks that stretch their meager resources even further. Consequently, stabilizing household income levels may be one of the most effective measures in reducing child labor, particularly in rural areas.

Income volatility arises, in part, from a lack of savings. Hence, access to credit may enable poor households to amass savings with which they can better cope with

adverse income shocks and eliminate the need for their children to work during these times of crisis. Chapter two highlighted econometric analyses conducted outside of Bangladesh that support the hypothesis that credit constraints are a major determinant in the likelihood of child labor within a household (Jacoby and Skoufias 1997; Ranjan 2001, 1999; Beegle, Dehejia and Gatti 2004; Guarcello, Mealli and Rosati 2002). If credit constraints engender children to work, then microfinance should have a positive impact on child labor in Bangladesh.

In fact, a number of studies show that microfinance stabilizes income in Bangladesh and renders households less vulnerable to negative income shocks, thereby diminishing child labor (Morduch 1998; Pitt and Khandker 1998; Khandker 1998). Although he finds that microcredit has negligible impact on the household income level of participants, economist Jonathan Morduch also finds income irregularity to be 47 percent lower for Grameen Bank members and 54 percent lower households participating in BRAC's microcredit program than those in a control group (Morduch 1998). Morduch highlights the fact that microcredit engenders more stable, but *not higher*, levels of consumption by diversifying the household labor supply across seasons (Morduch 1998, 3). If households that participate in microfinance programs have more resources from which to draw in times of crisis such as *monga*, then their children will either work less or not work at all.

Access to Credit may not have a Positive Impact at the Household Level

There are also a number of studies that contend that access to credit does not necessarily increase household consumption or have an overall positive impact on a borrower's family. Though he uses the same data set as Khandker and Pitt collected by the Bangladesh Institute of Development Studies (BIDS) and the World Bank, Morduch finds no evidence that microfinance increase participants' household consumption or the enrollment of their children in school relative to a control group (Morduch 1998, 30). Morduch's primary point of contention is his finding that 30 percent of Grameen Bank participants own more than the half-acre cutoff and thus any increase in income or consumption level is a function of their greater initial wealth. Though Pitt responds to Morduch's claims and demonstrates the validity of his original findings, this academic conflict illustrates that employing different econometric methods can produce inconsistent results.

Still, the work of scholars such as Aminur Rahman (1998) supports the view that microcredit may not always have a positive impact at the household level. In his anthropological analysis on Grameen Bank, Rahman explains that the push for self-sustainability within the microfinance industry has incited local bank workers to focus on increasing loan disbursement and ensuring timely repayment instead of monitoring and responding to the needs of their clients (Aminur Rahman 1998). As a result, borrowers are often forced to use what little savings and/or assets they may have in order to meet their weekly installments instead of using them for consumption, thereby making them worse off, and, in some cases, the pressure to repay loans on time can even incite domestic violence (Aminur Rahman 1998). Though microfinance has demonstrably improved the lives of millions of participants in Bangladesh, there are instances in which

the children of microfinance borrowers may be not better off than those of non-participants (Morduch 1998; Aminur Rahman 1998; Goetz and Sen Gupta 1996).

No empirical studies have been conducted on the relationship between microfinance and child labor in Bangladesh, however, data from other countries, economic models and field observations support the hypothesis that microcredit *can*, but does not usually, increase the workload of borrowers' children. In situations where social and institutional pressure for timely loan repayment is really as intense as Aminur Rahman posits children may be incited to work or may work more so that their parents can repay their loans on time. In an interview with ten boys aged 10-14 conducted at an informal school for child laborers operated by RDRS the children said that they sometimes have to use their salary for family emergencies or to help repay their parents' loan installments (RDRS 2007). In rural areas parents may not have work for three to four months during *monga*, and in the extremely poor region of Kurigram, children provide as much as 13 percent of total household income during this time (Lala 2007). According to the head of the Children's Savings Program established by Save the Children UK²² in Kurigram, more than 50 percent of participating children use their savings to help their parents repay loans (Lala 2007). This small sample may not be representative of the entire population, but it does support the hypothesis that microfinance can cause children to work as a result of pressure on borrowers to meet their weekly loan installments on time.

Another possible scenario is that as a borrower's self-employment increases, children may work more in the family business or be responsible for a larger share of

²² See conclusion for more information on the Children's Saving Program.

housework. Several studies presented in chapter two support the so-called “Wealth Paradox” which is the phenomenon that raising household income may actually increase the likelihood that children will work (Bhalotra and Heady 2003; Rogers and Swinnerton 2003; Edmonds and Turk 2004; Kanbargi and Kulkarni 1991). The intuition behind this is as the borrower’s business expands children serve as their most accessible resource for labor. Whether or not their parents are microcredit borrowers, 7.5 percent of children who work in Bangladesh do so primarily in a family business (MICS 2006, 101). Children who work in a family business may be less vulnerable to hazardous work and abuse than their counterparts in the wage labor market, but they are still detracted from regularly attending school.

Rural children may be particularly vulnerable to the “Wealth Paradox” where agriculture is the primary economic for both adults and children. Amin, Quays and Rives explain, “As families become wealthier, they own more land. More land requires more labor...and might prefer to have their own children do the work” for the sake of convenience (Amin, Quays, and Rives 2004, 22). Boys are more likely to be sent to work in the field when the landholdings of their household increase and girls are more likely to absorb a greater share of domestic tasks. As previously mentioned, women and girls are exclusively responsible for housework in Bangladesh. When parents send their sons to work the land, they are limited to working during the day and are not required to contribute to household chores. Credit that generates self-employment for female borrowers may have a more detrimental impact on girls than boys because women and their daughters are substitutes in the domestic labor supply. As a result, in addition to working in the fields, girls absorb the majority of household chores (Morduch 1998).

Microfinance may not be the Solution for Combating Child Labor in Bangladesh

Microfinance has the potential to actually increase the likelihood that children will work, therefore the provision of credit alone is not an appropriate solution to address the high prevalence of child labor in Bangladesh. Save the Children espouses the possibility that children do not benefit from microfinance:

It is clear that where parents participate in credit and savings programs, children's workloads *can* increase. Children may be asked to help with income-generating activities which have been started or intensified with the loan. They may also be expected to take on parts of their parents' or elder siblings' duties, such as domestic work or childcare, whilst older family members are busy generating income. In extreme cases, this can result in children working long hours, doing tasks that are too hard for them, endangering their health or dropping out of school. It should be stressed, however, that this is uncommon (Marcus, Porter and Harper 1999, 31; emphasis added).

In the long run, children are detracted from regular school attendance and denied the opportunity to receive an adequate education when they must work more as a result of credit provided to their parents. In the short run, however, most children enjoy the benefits of higher household consumption levels. According to Save the Children, "In most cases, children view the benefits such as eating better, having new clothes or shoes, better housing or attending school as outweighing the costs [of participating in credit and savings programs]" (Marcus, Porter and Harper 1999, 31). Studies from Bangladesh demonstrate that the households of microfinance participants do enjoy higher levels of per capita expenditure, net worth and nutritional well-being (Khandker 1998, 50), however, the true extent of Bangladeshi children who suffer from their household's participation in microfinance programs is unknown.

Appendix 4 summarizes field research which illustrates the counterintuitive overlap between child labor and microfinance. In an interview with a group of working

children participating in the Child Savings Program in Kurigram, 16 out of 17 children had parents who participated in a local microfinance program (Child Savers 2007).

Although there is a possibility of a self-selection bias in this group because a local microfinance NGO established the savings program, all of the borrowers were members of national MFIs. Overall, out of the 43 working children in this sample, 24 had parents who were microfinance clients. This may not constitute a majority, but it represents a large enough proportion of the sample to provoke further quantitative research. These field observations demonstrate that poor, rural households with extremely volatile incomes are more likely to send their children to work *and* more likely to participate in microfinance schemes as both mitigate their economic vulnerability during times of crisis.

Conclusion

Scholars and policymakers highlight the huge impact microfinance has had on alleviating poverty in Bangladesh, however, none have made a connection between access to credit and child labor. Poverty and child labor are intimately linked, but raising household income levels may not diminish child labor either because the increase is not sufficient to enable families to withdraw their children from work, or because poverty is not the *only* reason that children work. Moreover, although participation in microfinance programs increases the likelihood that children will enroll in school, it does not assure that households will withdraw their children from work. In some instances, self-employment and intense pressure to make timely repayments may actually cause children of microcredit borrowers to work more.

It is unclear whether microfinance increases school enrollment in Bangladesh because of its income-smoothing function, social programs that increase awareness in the community about the importance of education or another unknown variable. It is also unclear how many working children actually come from households that participate in microfinance programs. What is clear is that most children who work do not go to school and microfinance could potentially enable them to do so.

Child labor is a complex phenomenon that will only be mitigated through the development of political and economic infrastructure (i.e. improving enforcement of existing legislation and the education system; augmenting the availability of private credit), changing societal perception regarding childhood (i.e. child marriage; viable working age, gender inequality, etc.) and augmenting adult wages to such level that children have no need to work. The conclusion will provide a number of policy recommendations for enhancing the benefits of microfinance to include combating child labor.

Conclusions and Policy Recommendations

Bangladesh serves as an archetype for illustrating the challenges that most young, low-income countries face in choosing appropriate strategies to alleviate poverty. This thesis highlights the possibility that policies aimed at diminishing poverty through credit may not be the panacea their supporters uphold them to be. Though it has demonstrated great promise as an effective mechanism to increase the income of poor households in Bangladesh and around the world, the impact of microfinance cannot be analyzed solely in the context of economic data. According to the economic models presented in chapter two, access to credit and savings should induce parents to withdraw their children from work, however, raising household income levels in Bangladesh may not diminish child labor because either the increase is not sufficient to enable families to withdraw their children from work, or because poverty is not the *only* reason that children work. It is clear that Bangladeshi children living in households that participate in microfinance programs are more likely to go to school, but primary school stipends failed to significantly diminish child labor (Ravallion and Wodon 2000) which suggests that raising household incomes will not guarantee that children will attend school. In some cases, self-employment enabled by microcredit can actually cause the children of borrowers to work more which detracts from the possibility that they will attend school.

Though there have been a number of studies suggesting that there is a positive relationship between credit constraints and child labor, no research has been conducted analyzing the impact of access to microfinance on child labor. The data and observations presented in this thesis suggest that working children usually benefit from microfinance,

however, there is a certain household income level above which children do not need to work, and below which the increases in household income engendered by microfinance are not sufficient for parents to withdraw their children from work.

In order to determine this minimum income threshold and the extent of this phenomenon, a research team should conduct a quantitative study that explicitly isolates the relationship between child labor and microfinance. The basic premise of this study would be a comparison between a control group of households in which children work, but their parents do not participate in microfinance programs, and households with working children whose parents are microcredit borrowers. After collecting household survey data on school attendance, nutritional intake, living standards, and the reasons and number of hours that children work, a research team would run regression analyses and determine if there is a significant correlation between access to credit and the likelihood that children will work.

Despite the ambiguity of the relationship between access to credit and child labor, it is clear that microfinance could be tailored to address the needs of working children and their households. In order to enhance the effectiveness of microfinance in diminishing child labor, the author recommends that credit providers collaborate with child labor advocacy groups to target the parents of working children. Padakhep, for example, a national NGO, has drop-in centers that provide education, health, and counseling services for street and working children. After a number of years, the parents of participants can become eligible to receive microcredit through their children. Similarly, MFIs could establish programs that specifically target the parents of working children and advocacy groups could facilitate dialogues or educational programs aimed at

slowly altering societal perceptions of childhood. Another approach would be to provide microcredit to the parents of working children only if they agree to withdraw their children from the labor force and limit the number of hours they work in domestic activities. The MFI-children's rights group partnership could then establish formal or informal schools and utilize international donors to subsidize expenses such as school supplies until parents begin to accrue savings.

A radical and alternative solution is to provide working children with savings accounts, and in some rare cases, small loans to generate income. In 1998, Save the Children UK in Bangladesh launched an unprecedented program known as the Children's Saving Program in tandem with local NGOs that provide microfinance to adults. Working children generally contribute all of their wages to their parents for immediate consumption and lack the opportunity to save any of their earnings to mitigate against household crisis or buy things for themselves. In the Children's Savings Program, field workers visit child laborers at their home or workplace and enable them to deposit or withdraw money at any time. There are now 800 child savers in the program. In an interview with program participants in Kurigram, the majority of children said that they used their savings to help their families cope with crises such as illness, crop failure, and flooding, pay for their education or that of their siblings and to buy presents for the Muslim holiday, Eid (Child Savers 2007). Many of the children have also supplemented their meager incomes by purchasing ducks or other small fowl and selling the eggs in the local market. Most of these boys work in agriculture tending to cattle belonging to either their parents or a neighbor while the majority of girls roll *bidi*, or thinly-rolled cigarettes, which is a common economic activity for female children because it is conducted within

the household. Local *bidi* agents bring rolling papers and materials to girls at home and then come by to collect them and sell them to large distributors. The girls explained that if they fail to meet their deadline, they get treated badly by their employers. Still, participants in the program assert that life has improved since they began saving. Though they articulated that they generally liked to work, they recognized the lack of viable alternatives: “We have to work to live,” they explained authoritatively, “If we don’t work, we don’t have food.” Others asserted, “If I don’t work, I can’t continue my education.” These responses illustrate that most working children recognize that child labor is not a choice, but a necessity.

Bangladeshi society is neither archaic nor ignorant, but adult wages in the unskilled labor market simply have not increased enough to render children’s economic contribution unnecessary at the household level in extremely poor families. If and when demand for skilled labor increases and augments average adult wages such as during the Industrial Revolution in Britain (Nardinelli 1990) then there will be less demand for children in the labor market. Moreover, the current void of a vibrant skilled labor market discourages impoverished children and adult workers to value higher education. Though the Bangladeshi economy has been diversified over the past two decades, service and industry jobs that demand unskilled labor dominate the labor market. In the long run, increasing the demand for skilled labor requires private investment, technological advancement and economic diversification. A substantive rise in adult wages may diminish both the demand for and the supply of children in the labor market as formerly destitute households will no longer find it necessary to send their children to work. Increasing adult wages would change household labor market decisions such that the

Luxury Axiom no longer applies and parents can afford to send their children to school. Unfortunately, child labor is not merely a function of wage labor market composition therefore such an economic transformation may not yield such results.

Microfinance and child labor are relatively unimportant issues in light of the fact that most of Bangladesh is now in shambles as a result of Cyclone Sidr. In the short term, it is vital that the government feed and house its people and rebuild its infrastructure. In the long run, however, a reappraisal of the impact between microfinance and child labor could maximize its effectiveness and protect the rights of millions of children to education and leisure.

APPENDIX 1: Primary Microfinance Providers in Bangladesh

PKSF

The Palli-Karma Sahayak Foundation (PKSF) (Rural Employment Support Foundation) is an apex institution founded by the government in 1990 that gives financial support for the majority of microfinance providers in Bangladesh. In 2003-2004, PKSF lent over \$58 million US to 206 microfinance organizations throughout the country though the primary recipients of these funds were ASA, BRAC, and Proshika (Credit and Development Forum 2006, 17). In 2004, PKSF funded 17 percent of the total microfinance industry in Bangladesh (CDF 2006, 17).

ASA

ASA, or “hope” in Bengali, was established in 1978 and began its microcredit and savings program in 1991 (CDF 2006, 13). A minimalist MFI, the only services ASA offers are small loans targeted to extremely poor women, and small business loans that are “usually given to men but given to women subject to demonstrating confidence in business” (CDF 2006, 13). ASA has achieved a recovery rate of 99 percent and currently has over 3 million members (CDF 2006, 13).

PROSHIKA

PROSHIKA was established in 1976 as an NGO committed to combating poverty in a number of ways including practical skill training, savings, and small enterprise development programs that provide microloans paired with formal business training,

technical and marketing support, etc. Another microfinance program involves educating the poor about livestock, fishery, agriculture, organic agriculture, and irrigation in order to augment their household income. PROSHIKA works with nearly 2.75 million men and women in rural and urban areas throughout Bangladesh (CDF 2006, 12).

APPENDIX 2: Child Labor in Bangladesh

Percentage of children aged 5-14 years who are involved in child labor activities, by type of work.

Source: Bangladesh Multiple Indicator Cluster Survey conducted by the BBS 2006 (102).

QuickTime™ and a
TIFF (LZW) decompressor
are needed to see this picture.

APPENDIX 3: Laborer Students and Student Laborers in Bangladesh

Percentage of children aged 5-14 years who are laborer students and student laborers.

Source: Bangladesh Multiple Indicator Cluster Survey conducted by the BBS 2006 (103).

QuickTime™ and a
TIFF (LZW) decompressor
are needed to see this picture.

**APPENDIX 4: Observations from the Field - Interviews with Working Children
June-July 2007 (see attached)**

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