

MICROENTERPRISE: HUMAN RECONSTRUCTION IN AMERICA'S INNER CITIES

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I. INTRODUCTION

Gloria Davis has traveled what seems like a very long road—from welfare mother to successful entrepreneur in only two years. Ms. Davis now operates a designer dress shop called Neo Emporium on North Clark Street in Chicago.¹ The store sells designer clothing on consignment and offers custom-designed clothing.² Ms. Davis, who sewed bridesmaids' dresses at home when she was not going to trade school or raising her children, got her first loan from the Women's Self-Employment Project—for a grand total of \$715.³

Ms. Davis is an early success story in a promising new approach to the seemingly intractable poverty of America's urban underclass.⁴ This approach is usually referred to as microenterprise, a development model in which small loans and peer support are made available to those interested in starting "small" small businesses. Unlike the wide range of government-sponsored welfare programs that seem to contribute to the dependency and despair of the underclass,⁵ microenterprises can potentially break the cycle of dependency and hopelessness by restoring initiative, responsibility, and dignity.⁶

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1. See John McCarron, *Boutique Puts Poverty in its Place*, CHI. TRIB., Sept. 19, 1990, Chicagoland sec., at 1.

2. See *id.*; Patti Wolter, *Women's Self-Employment Fund Coming Full Circle*, THE NEIGHBORHOOD WORKS, Dec. 1990-Jan. 1991, at 8.

3. See McCarron, *supra* note 1, at 1.

4. The problems of this underclass extend beyond the distressingly familiar economic statistics of unemployment and underemployment to even more dismal accounts of declining human and family values, anti-social behavior, drug addiction, teenage pregnancy, single-mother families, and an abysmal public education system. See, e.g., WILLIAM J. WILSON, *THE TRULY DISADVANTAGED* (1987).

5. See generally CHARLES MURRAY, *LOSING GROUND: AMERICAN SOCIAL POLICY, 1950-1980* (1984). For a summary of the empirical literature disputing the link between welfare and low self-esteem, see *THE SOCIAL IMPORTANCE OF SELF-ESTEEM* (Andrew M. Mecca et al. eds., 1989).

6. See JIM SLEEPER, *THE CLOSEST OF STRANGERS: LIBERALISM AND THE POLITICS OF RACE IN NEW YORK* (1990). See generally SHELBY STEELE, *THE CONTENT OF OUR CHARAC-*

This article examines the creation of an urban self-employment and entrepreneurial culture through microenterprises. Microenterprises can provide the inner-city poor with desperately needed capital, while reducing their reliance on redistributive government programs. Microenterprises are especially important in inner-city areas where there are few formal job opportunities. Often home-based, these businesses usually employ fewer than five persons, are typically capitalized with less than \$5,000, and gravitate toward retail or service activities.⁷ Recent microenterprise development programs focus on revolving loan funds, frequently organized as nonprofit organizations,⁸ which make very small, short-term working capital loans to individuals who wish to start or expand a small business. This type of lending requires neither collateral from borrowers nor a job history or credit rating.⁹

Microenterprise loans are unattractive to commercial banks. The transaction costs of a small loan are high relative to the interest and fees the loan generates. For example, the costs to originate and service a \$1,000 loan approximate those associated with a \$100,000 loan.¹⁰ Most loans, regardless of size, require similar time, expertise, and paperwork to review, originate, and service. In addition, the microenterprise borrower typically has few assets that can serve as collateral. Many of these entrepreneurs have no credit history and are not personally known to the bank lending officers.

Government programs have not figured prominently in microenterprise financing. Generally, government programs are oriented to larger, more sophisticated, small businesses. Thus, as one economic development organization concluded, "[d]espite the lack of hard evidence, there appear to be capital

TER (1990) (emphasizing the need for hard work, stable family life, individual initiative, and self-reliance).

7. See *Microenterprise Lending: Help for the "Small" Small Business*, ALERT (Community Info. Exch., Wash., D.C.), May-June 1990, at 1.

8. In general, nonprofit organizations are classified by their restriction on any distribution of profits or dividends to constituents. See, e.g., MODEL NONPROFIT CORP. ACT § 17.07 (Exposure Draft 1986). Although they are arguably inefficient because of a lack of a profit incentive, nonprofits nonetheless continue to thrive in a variety of contexts. See generally Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 840 (1980) (providing a paradigm to classify and explain the viability of the various kinds of nonprofit organizations).

9. See *Creating an Entrepreneurial Culture: Microenterprises in the Southern Economy*, SGPB ALERT: ANALYSIS OF EMERGING ISSUES (Southern Growth Policies Bd., Research Triangle Park, N.C.), Apr. 1990, at 4, 7 [hereinafter *Creating an Entrepreneurial Culture*].

10. See *id.* at 4.

needs in the microenterprise sector which are not met by the banking community and existing governmental programs.”¹¹

The efforts of a bank in Bangladesh provide the paradigm for implementing microenterprise lender programs in the United States. This Third World example demonstrates the potential success of credit programs in enabling the poor to improve their economic status, and shows how crucial the structure of the lending process is to the achievement of this goal. After investigating the structure of microenterprise lending, this article assesses the efforts of micro-bankers in the United States to provide the inner-city poor with the necessary resources for self-employment. Although this inexpensive, market-oriented, entrepreneurial solution can help alleviate poverty and promote economic development, various governmental and social obstacles currently hinder its implementation. This article proposes various means to alleviate these barriers and considers potential contributions from the private and public sectors. These contributions, combined with a broader role for the micro-banker, are necessary before microenterprises will flourish.

II. THE GRAMEEN BANK'S SUCCESS

It is not anomalous to look to poor Third World nations when analyzing the social and economic impact of small amounts of credit assistance on the lives of American poor. The dire circumstances of the Third World poor have spawned some of the most innovative and successful alternatives to the formal economy.

The informal economic sector of the Third World, chronicled in Peru by Hernando de Soto, consists of microenterprises in sprawling urban centers and rural villages.¹² Entry-level microenterprises include vendors peddling their wares on street corners, farmers and traders selling locally-grown and produced foodstuffs, and entrepreneurs engaging in a variety of service and repair activities.¹³ Informal-sector enterprises

11. *Id.* at 5.

12. See HERNANDO DE SOTO, *THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD* (1989) (documenting the success of the burgeoning free enterprise class in Lima, Peru); see also Sheldon Annis & Jeffrey Franks, *The Idea, Ideology and Economics of the Informal Sector: The Case of Peru*, 13 GRASSROOTS DEV. 1989, at 9, 19 (describing Peru's informal economy as its most viable alternative toward economic stability).

13. De Soto points out that most of these services operate illegally because Peruvian

comprise 80-90% of the business activities in a typical poor Third World urban neighborhood or village, and employ from 30-70% of a developing nation's labor force.¹⁴ Informal-sector businesses often rely on family members for capital and labor. The informal sector is relatively easy to enter, family-owned, unregulated, small-scale, competitive, labor-intensive, and permits resources to be adapted from one use to another.¹⁵

In developing nations from Bangladesh to Peru, entrepreneurs seek to emerge from constant indebtedness to loan-sharks, informal moneylenders, and traders, and receive full compensation for their labor. All too often, however, informal financial intermediaries extract high rents, thereby reducing the income stream to the entrepreneur. Consequently, a poor person may need a new credit source that will enable her to build up her asset base and realize an increased share of the funds derived from her work.¹⁶

Rigid collateral requirements, credit guarantees, and inflexible repayment schedules make it difficult, if not impossible, for microenterprise borrowers to obtain credit from formal financial sources. Commercial banks regard loans to microenterprises as too risky and costly to administer. Small, informal enterprises that are not formally-registered businesses may be automatically deemed uncreditworthy. Substantial transaction costs deter aspiring micro-entrepreneurs from obtaining credit. Furthermore, an overwhelming percentage of the population of most Third World countries lacks the requisite literacy to engage in bank transactions.

The Grameen Bank (the "Bank") in Bangladesh, founded in 1983, is a pioneer in uncollateralized microenterprise lending, and has serviced hundreds of thousands of borrowers.¹⁷ This institution has successfully tested the hypothesis that the poor

law is riddled with mercantile-based requirements and obstacles hindering individual initiative. See DE SOTO, *supra* note 12, at 201-17.

14. See STAFF OF SELECT COMM. ON HUNGER, 100TH CONG., 1ST SESS., ACCESS AND AVAILABILITY OF CREDIT TO THE POOR IN DEVELOPING COUNTRIES AND THE UNITED STATES 2 (1988) [hereinafter SELECT COMM.]; see also Timothy Aepfel, *Helping the Developing World - One Entrepreneur at a Time*, CHRISTIAN SCI. MONITOR, Mar. 20, 1987, at 1.

15. See Paul Strassman, *Home-based Enterprises in Cities of Developing Countries*, 36 ECON. DEV. & CULTURAL CHANGE 121, 125 (1987-88).

16. See Muhammed Yunus, *The Poor as the Engine of Development*, 10 WASH. Q. 139, 142-43 (Autumn 1987). Cash also enables the informal worker to select better quality materials more likely to sell, thereby increasing sales volume and money earned. See Maria Otero, *Rethinking the Informal Sector*, 13 GRASSROOTS DEV., 1989, at 3, 5.

17. See SELECT COMM., *supra* note 14, at 41; see also Otero, *supra* note 16, at 5.

can engage in productive self-employment if supplied with capital.¹⁸ The Bank is a borrowers' cooperative, with borrowers owning 75% and the government owning the remainder of the Bank's shares.¹⁹ As a private entity, the Bank sets its own policy and has its own branches and staff. Except for foreign exchange transactions, the Bank is empowered to conduct the full range of banking functions.²⁰

Like typical commercial banks, the Grameen Bank has established branches within the community to facilitate reaching its target population. Because the target group is mostly illiterate and timid in approaching banks, the Bank employs field workers who bring the Bank to the borrowers' doorsteps by entering villages to disseminate information about the Bank, promoting the formation of borrower groups, and collecting repayments. Because many of the loans resemble one another, the Bank benefits from economies of scale, with one bank representative able to monitor thousands of loans on a weekly basis.²¹ The Bank's average loan is \$67.²² The annual interest rate of 16%²³ contrasts with the typical interest rates of 120 to 200% per year charged by Bangladesh moneylenders.²⁴

Between two-thirds and three-quarters of the Bank's borrowers are landless women.²⁵ The Bank concentrates on female borrowers, whom it regards as having a greater interest in family stability than males.²⁶ As Muhammed Yunus, the founder of the Grameen Bank, notes,

Given an opportunity to fight against hunger and poverty, a poor woman turns out to be a natural and better fighter than

18. See MAHABUB HOSSAIN, INTERNATIONAL FOOD POL'Y RES. INST., CREDIT FOR ALLEVIATION OF RURAL POVERTY: THE GRAMEEN BANK IN BANGLADESH 65 (Feb. 1988).

19. See Clyde Farnsworth, *Micro Loans to the World's Poorest*, N.Y. TIMES, Feb. 21, 1988, § 3, at 10.

20. See Rone Tempest, *Breaks Many Rules*, L.A. TIMES, Nov. 28, 1987, at 1.

21. See Farnsworth, *supra* note 19.

22. See Muhammed Yunus, *Perspectives on Houston Summit*, L.A. TIMES, July 9, 1990, at B5.

23. A 16% annual interest rate is comparable to the rate charged for agricultural loans by other Bangladesh banks. The interest payment, however, is 8.12% of the loan because repayment is amortized over fifty weeks. See SELECT COMM., *supra* note 14, at 42.

24. See SELECT COMM., *supra* note 14, at 9.

25. See *id.* at 41 (65%); Yunus, *supra* note 16, at 145 (74%); Tempest, *supra* note 20 (about 80%). In 1986, females constituted 74% of the Bank's borrowers and accounted for 69% of outstanding loans. See HOSSAIN, *supra* note 18, at 9.

26. See Tempest, *supra* note 20; see also HOSSAIN, *supra* note 18, at 34; Helen S. Cohen, *How Far Can Credit Travel?: Adapting the Grameen Bank's Self-Employment Model*, 21 ECON. DEV. & L. CTR. REP. 3, 5 (1990).

a poor man. Poor women have the intense drive to move up, they are hard working, concerned about their human dignity, concerned about their children's present and future, willing to make personal sacrifices for the well-being of their children.²⁷

Indeed, according to a Congressional study, "[w]omen are disproportionately recognized in the informal economic sector. In Peru, when domestics are excluded, 40% of the informal sector labor force and 61% of the self-employed are women."²⁸ Third World females often lack access to formal-sector employment. Home-based informal sector activities comprise their only means of earning a livelihood and providing child care.²⁹

The landless poor have benefitted directly from extended credit through favorable loan repayment rates, increases in income and the accumulation of capital, and growth in savings. Since the Bank's inception, loan repayment has reached the enviable rate of 98%.³⁰ The primary factors underlying this high rate are the Bank's use of solidarity groups and its policies of short-term loans and incremental lending.³¹

The formation of solidarity groups provides an effective mechanism for the Bank's expansion of credit assistance to the poor. As part of the Bank's structure, borrowers must form groups of five to be eligible for uncollateralized loans.³² Before any group member obtains a loan, the entire group undergoes a training session, spanning one to two weeks, to learn the Bank's strictly-enforced rules and procedures and to help members develop their business skills.³³

This group lending process prepares a borrower to receive

27. Yunus, *supra* note 16, at 144-45.

28. SELECT COMM., *supra* note 14, at 3.

29. See Otero, *supra* note 16, at 4. Otero notes that while women may comprise up to 60% of the informal work force, they are concentrated in traditional domestic activities, which are least profitable. *Id.* at 8.

30. See Yunus, *supra* note 22.

31. See SELECT COMM., *supra* note 14, at 14-15. Other factors contributing to the Bank's laudable repayment success include (1) the ability of the Bank to confine services to only the most needy; (2) an intricate management system including a decentralized structure and intense training of Bank employees; (3) collection of repayment in small amounts suitable to the circumstances of the poor borrower; and (4) the attitude of the Bank employees who view their work as an opportunity to serve the poor rather than as merely a means of income. See HOSSAIN, *supra* note 18, at 10.

32. See HOSSAIN, *supra* note 18, at 25. A five-member group ensures mutual trust and confidence as well as responsibility. Through early experimentation, individual loans proved to be uncontrollable for Bank staff, and groups greater than five failed to foster the crucial group cohesion. See *id.*

33. See SELECT COMM., *supra* note 14, at 10-11, 42.

funds and run a business.³⁴ In addition to attending a training session, the group elects officers (a chair and a secretary) and must pass a "test" at the end of the training session before obtaining a loan from the Bank. The members must demonstrate to the staff their seriousness and integrity, and their knowledge of the Bank's rules, procedures, and programs.³⁵ After the initial training period, each group member attends weekly group meetings with an officer of the Bank who is trained in small-scale financial activities.³⁶ The group provides the individual with the reassurance to take business risks he may not have undertaken otherwise, creates a foundation for larger business ventures (collective or joint enterprises) that individuals perceive as too risky to undertake alone, and most important, pressures the borrower to meet loan repayment schedules and other obligations to the Bank and to the group.³⁷

A solidarity group relies on peer pressure throughout its process.³⁸ Group members are aware of the character of any prospective member; they eliminate individuals the group views as unlikely to repay a loan. The group process also prepares an individual to receive a loan and increases the likelihood of repayment. Group lending lacks confidentiality because all discussions and transactions take place at group meetings. By candidly discussing all loan requests at group meetings, the group scrutinizes each member's prospective enterprise, and analyzes the enterprise's potential profitability, the borrower's management finesse, and the borrower's commitment.³⁹ Group members strive to avoid approving business ideas that are not feasible and share ideas to make businesses more profitable. Such scrutiny ensures that enterprises receiving loans "are more likely to be well thought out and are likely to make a profit from which they can repay the loan."⁴⁰ As long

34. *See id.*

35. *See id.*

36. *See id.* These weekly meetings also involve a social development component. For instance, members reaffirm and discuss at weekly meetings a program known as "Sixteen Decisions," which was introduced by the Bank to imbue members with discipline, unity, and the goal of improved standards of living. *See infra* note 160 and accompanying text. Such programs correspondingly improve loan recovery. *See HOSSAIN, supra* note 18, at 27.

37. *See SELECT COMM., supra* note 14, at 10.

38. *See* Gerald Sherman, *Micro-Enterprise Lending: The Grameen Bank-Lakota Fund Experience*, Soc. POL'Y, Fall 1989, at 64.

39. *See id.* at 66.

40. *Id.*

as the loan is outstanding, group members continue to monitor it. Group members question the borrower regularly to prevent him from mispending money. By furnishing evidence to the group of the disbursement of loan proceeds, borrowers "are more apt to operate their business properly since they will be examined by others frequently."⁴¹

The mode of loan disbursement significantly enhances the power of peer pressure. If one member of a five-member group receives a loan, the others are ineligible until the first member (or two members) demonstrates regular payment of the weekly installment.⁴² Thus, if one individual is unable to make timely repayments, she jeopardizes credit availability for the entire group. The group will encourage a delinquent member to alter her loan repayment behavior, and may even resort to making the missed payments. Repeat loans are not approved for any member until the accounts of all members are settled.⁴³ This process ensures mutual accountability and serves as a form of moral collateral.⁴⁴

In addition to enhancing the repayment rate by borrowers, the group provides other advantages to the Bank (and ultimately to the borrowers). Treating the borrowers as a group throughout the loan process enables the Bank to reduce its analysis of each loan application, thereby decreasing the high transaction costs that, as previously noted, discourage loans to small businesses. Because group members assume mutual responsibility for each others' loans, the Bank can reduce staff time devoted to tracking loans and service more borrowers.⁴⁵

Up to ten groups of borrowers (or a total of fifty borrowers) in one area comprise a "center" and elect a center chief and deputy center chief.⁴⁶ Several centers, in turn, form a branch. The center chief and her deputy, together with a Bank officer, conduct weekly meetings of the center, discuss strengths and weaknesses of business ideas, recommend loan proposals, and oversee loan activities.⁴⁷ Each group formulates and analyzes loan requests that are reviewed and approved by the center

41. *Id.*

42. See HOSSAIN, *supra* note 18, at 26.

43. *See id.*

44. *See id.*

45. *See Creating an Entrepreneurial Culture, supra* note 9, at 7-8.

46. *See* SELECT COMM., *supra* note 14, at 42.

47. *See id.*

chief, a Bank worker, a program officer, and, finally, the Bank's branch and zone manager.⁴⁸

Two other factors contribute to loan repayment success. First, the loans are for a one-year term, with the principal repaid in fifty equal weekly installments and the interest paid in the fifty-first and fifty-second installments.⁴⁹ Second, the Bank lends incrementally, giving each group member a small initial loan to avoid overwhelming the borrower with too much cash, and simultaneously reducing the likelihood that the borrower will mispend the funds. Once the borrower repays the first loan, subsequent loans can be larger in amount and have a longer repayment period. The incremental lending technique provides incentives to the borrower and minimizes the risk to the Bank.⁵⁰

The income and savings impact of a microenterprise loan are also noteworthy. One study showed that over a two and one-half year period in the mid 1980s, household incomes among Bank borrowers rose approximately 70% in nominal terms.⁵¹ This income gain was particularly notable in comparison to the average annual income increase of 2.6% for the landless and rural poor in Bangladesh.⁵² Because traders and shopkeepers are over-represented as Bank borrowers and agricultural laborers are under-represented, it is unclear, however, how much of the vast income differential is due to initial differences in the composition of the Bank's borrowers and how much results from improved access to credit.

Increased access to capital enables the poor to use their skills more productively. Borrowers often use part of the borrowed funds to initiate additional income-generating activities. For example, before establishing a venture funded by the Bank, 50% of the Bank's borrowers listed one income-generating activity.⁵³ Upon receiving Bank funds, however, the number of borrowers with two income-generating activities increased by 20% while the number of borrowers with three income-gener-

48. *See id.*

49. *See id.*

50. *See id.*

51. *See id.* at 6; *see also* HOSSAIN, *supra* note 18, at 64-67 (finding that Bank members have incomes significantly higher than those of comparable non-Bank members).

52. *See* SELECT COMM., *supra* note 14, at 6.

53. *See id.* at 7.

ating activities increased by 24%.⁵⁴

The availability of credit enables microenterprise borrowers to save money more easily. One study indicated that during a four-year period in the mid-1980s, the Bank extended over \$30 million in loans, and the borrowers saved a total of over \$3 million.⁵⁵ Correspondingly, Bank members have experienced an enhanced standard of living.⁵⁶ Savings by group members result from two main sources. Each member participates in a group savings program that requires weekly deposits into a savings account.⁵⁷ Each borrower also pays a group "tax" of five percent of any loan amount received.⁵⁸ These group funds, consisting of the weekly savings by all group members and the group "tax" paid by all borrowers, serve two purposes. First, the funds give the borrower a greater stake in the venture as well as a resource for other investments in her financial future. Group members can borrow from the group fund for investment and consumption purposes with the consent of the group members. If a member leaves the group, she may withdraw the personal weekly savings, but not the five percent deduction.⁵⁹ Second, the savings requirement provides additional capital for the Bank.⁶⁰ Group members must also contribute to an emergency fund equal to 25% of the interest charged by the Bank on its loans.⁶¹ Group members use these funds for health, life, and property insurance.⁶² Over time, the borrowers earn and save enough to increase their investment capacity, while simultaneously providing greater financial security for future contingencies, and greatly reducing their need to rely on external sources of funds.

The Bank provides loans to microenterprise borrowers whom a typical bank would categorize as too costly. While

54. *See id.* Borrowing from the Bank is associated with rapid capital accumulation. The average Bank borrower had tripled the value of her working capital twenty-seven months after receiving a loan. *See HOSSAIN, supra* note 18, at 10.

55. *See SELECT COMM., supra* note 14, at 6-7.

56. *See HOSSAIN, supra* note 18, at 67-69. Hossain also credits enhanced social development, which results from group training, as alleviating poverty. *See id.* at 69.

57. *See id.* at 26; *see also SELECT COMM., supra* note 14, at 42.

58. *See SELECT COMM., supra* note 14, at 42.

59. *See HOSSAIN, supra* note 18, at 26.

60. *See SELECT COMM., supra* note 14, at 15, 42. The group funds are accumulated in an account held by the Bank and are managed consensually by the group. *See HOSSAIN, supra* note 18, at 26.

61. *See SELECT COMM., supra* note 14, at 42.

62. *See id.*

some of the Bank's practices, such as shifting loan-tracking responsibilities to the group, conserve operating costs, other aspects of the Bank's unconventional techniques, such as training members and collecting weekly payments, result in higher costs than the typical rural credit program.⁶³ The major source of funds for the Bank are loans from domestic and foreign banks, grants, and deposits contributed by members to the emergency and weekly savings funds.⁶⁴ While the Bank operated at a profit of 2.8% of its loan volume in 1984, the following two years yielded no profits.⁶⁵ Studies indicate that the Bank may need a subsidy through access to low-cost credit for its operations.⁶⁶

The Grameen Bank experiment demonstrates the possibility of providing credit to the poor despite their lack of collateral. The Bank's success suggests that the poor can improve their socio-economic status through microenterprises if given the opportunity. Rather than addressing poverty through tradi-

63. See HOSSAIN, *supra* note 18, at 70. The cost of the Grameen Bank's loan operation is substantially higher than its 16% rate of interest. *Id.* The high operating costs are not a result of loan loss, which is minimal, but rather stem from administering an intensive micro-loan portfolio. See David Hulme, *Credit for Low Income Groups: Some Lessons of Experience*, 25 COMM. DEV. J. 175, 177 (1990).

64. See HOSSAIN, *supra* note 18, at 70. Funds deposited by nonmember households constitute an insignificant source. See *id.*

65. See *id.* at 74; cf. *Creating an Entrepreneurial Culture*, *supra* note 9, at 7 (stating that the Bank lending operations have been profitable since 1986).

66. See, e.g., HOSSAIN, *supra* note 18, at 75-76. In 1986, for example, observers estimate the Bank's cost of loan operations at 21.7% per year, namely, cost of administration at 18.1% of the total amount of loans and cost of funds at 3.6% relying on two highly subsidized loans from the International Fund for Agricultural Credit (IFAC). If these low-cost loans were unavailable, funds would have cost the Bank 8.5% thereby increasing the cost of loan operations to 26.6% per year. Even if the Bank could cut its cost of administration to 9.3% (based on the experience of established branches), the cost of loan operations would approximate 20.3% (including an assumed 2.5% for overhead expenses). The figures for 1986 are, however, distorted by large salary increases. The operating costs for the Bank are high because of the participation of Bank employees in social development activities as well as intensive supervision of borrowers. See *id.* at 11, 74-76.

Hossain found that the Bank has avoided a subsidy thus far by drawing on a low-interest, long-term loan (from the International Fund for Agricultural Credit) in excess of its actual needs, and investing these funds in fixed and short-term accounts. Hossain warns that adverse conditions could require the Bank to seek a direct subsidy from the government or increase the borrower's interest rate. See *id.* Such dependence may present a considerable constraint of expansion and limits the Bank's relevance to those credit institutions that cannot rely on highly subsidized capital. See Hulme, *supra* note 63, at 175. Other studies recommend that the Bank charge a market interest rate instead of the current 16% rate. See *Creating an Entrepreneurial Culture*, *supra* note 9, at 8. See generally *Microenterprise Credit: Joint Hearing Before the Comm. on Hunger and the Subcomm. on Int'l Dev. Inst. and Fin.*, 99th Cong., 2d Sess. 17, at 17-18 (1986) (comments of Muhammad Yunus, founder of the Grameen Bank). The Bank might also increase the maximum loan size and require repeat borrowers to repay loans monthly or quarterly thereby reducing transaction costs. HOSSAIN, *supra* note 18, at 78.

tional welfare approaches, the Bank empowers solidarity groups to manage their own funds and monitor their own loan group, substituting peers who provide support for outside authorities who merely pressure. The Bank's experience demonstrates a link between economic revitalization and an improved social structure,⁶⁷ providing a valuable guide to other countries. The concept of generating self-employment through credit monitored by groups of small borrowers may work elsewhere, provided that the program accounts for varying social and economic structures.

III. MICROENTERPRISE EFFORTS IN THE UNITED STATES

American microenterprise lenders have also sought to create the conditions that would enable poor people to generate a livelihood through self-employment. These lenders recognize that entrepreneurs require access to capital for start-up financing. Microenterprise lenders assume that access to capital and the entry of microentrepreneurs into the market improves economic welfare. Microenterprise lending involves more than merely providing funds to the disadvantaged; it promotes entrepreneurial development as a strategy for greater self-sufficiency, self-esteem, and autonomy. Loans are made on the premise that inner-city residents are individuals with considerable potential. To tap this potential, microenterprise lenders have developed a variety of programs.

A. *The Women's Self-Employment Project*

One of the leaders in the area of community economic development,⁶⁸ the Women's Self-Employment Project (WSEP), based in Chicago and incorporated in 1986, provides training

67. See Cohen, *supra* note 26, at 8. For example, dozens of loan groups have organized community schools, gardens, and latrines. See ALAN B. DURNING, ACTION AT THE GRASSROOTS: FIGHTING POVERTY AND ENVIRONMENTAL DECLINE 31 (Worldwatch Institute, Worldwatch Paper 88, Jan. 1989).

68. There are numerous organizations and programs offering support for self-employment ventures. See, e.g., THE NEIGHBORHOOD INSTITUTE, ORGANIZATIONAL DESCRIPTION 1 (summarizing details of low-income borrower groups and loan procedures). For a survey of American and Canadian microenterprise lenders, see CORPORATION FOR ENTERPRISE DEVELOPMENT, INTERIM LESSONS LEARNED FROM SELF-EMPLOYMENT PROGRAMS FOR THE DISADVANTAGED: A STUDY OF U.S. AND CANADIAN PROGRAMS AND POLICY PERSPECTIVES (Aug. 1990). See also CORPORATION FOR ENTER. DEV., INTERIM LESSONS FROM THE SELF-EMPLOYMENT INVESTMENT DEMONSTRATION: EXECUTIVE SUMMARY (Oct. 1991) (reviewing the progress of the Self-Employment Investment Demonstration and its operation in five states).

and financing for low-income women to start their own microenterprises.⁶⁹ WSEP promotes self-employment as a transition from welfare to meaningful work or as a supplement or alternative to low-wage jobs. WSEP strives to provide access to credit to enable low-income women to become economically self-sufficient.

WSEP runs two complementary programs: (1) its original self-employment training program and loan fund for individual women and (2) the Full Circle Fund (the "Fund"), started in 1988 as a peer group microenterprise revolving-credit program modeled on the approach pioneered by the Grameen Bank.⁷⁰ In the original program, women participate in a twelve-week training program and formulate business plans, upon the completion of which they may apply for individual loans.⁷¹ The training concentrates on both business skills and self-development. To receive a WSEP loan, the borrower must provide collateral of 50% of the loan's value.⁷² The Fund, WSEP's second program, does not impose such a collateral requirement. In the Fund, women organize themselves into groups of borrowers. The Fund's primary objective is to provide credit that will enhance the income-generating capacities of the microenterprises. As of early 1991, the Fund had a loan fund of \$190,000 and seventeen groups of borrowers organized under the Fund's sponsorship.⁷³

The Fund tries to reach the most poverty-stricken and seeks to extend credit to those who, by traditional commercial banking standards, would appear to be the least creditworthy. This approach requires considerable community outreach and coordination with other community-based institutions that can refer individuals from their own neighborhoods. The Fund strives to bring Third World village banking to urban neighborhoods. A Fund staff member or "enterprise agent" enters low-income neighborhoods to find borrowers through a variety of methods, including community organizations, community publications, and word-of-mouth.⁷⁴ The enterprise agent meets prospective

69. See LYNNE GELLATLY, *WOMEN'S SELF-EMPLOYMENT PROJECT: AN OVERVIEW* 4-5 (Spring 1990).

70. See *id.* at 5, 7.

71. See *id.* at 5-6.

72. See *id.* at 7.

73. Telephone Interview with Susan Matteucci, Senior Enterprise Agent, Full Circle Fund (Jan. 16, 1991).

74. See Cohen, *supra* note 26, at 8.

borrowers on their own turf—in the home, in religious organizations, on the streets—rather than in a downtown office. The agent identifies potential borrowers. Additionally, the agent meets with borrowers, facilitates group meetings, and monitors each loan.⁷⁵

The Fund provides short-term (one year) loans to women to start or expand a self-employment enterprise.⁷⁶ The initial loan is limited to \$1,500 and the maximum loan cannot exceed \$10,000.⁷⁷ A borrower must belong to a group (a "Circle") of five women who are self-employed or who wish to become self-employed. The Circle members reside in the same community, enhancing their knowledge and trust of each other. They select group members based on the assumption that they will be comfortable in a long-term affiliation with each other. Family members or business partners cannot belong to the same group, but may participate by joining a separate group.⁷⁸

The Circle members participate in an orientation process which culminates in their certification as an official borrowing group.⁷⁹ An orientation session, spread over four weeks, serves to familiarize the group members with the Fund's rules and regulations; the general rules for borrowing and repayment; basic business skills, such as the need for maintaining budgets and separating business and personal funds; formulation of a business plan; and the creation of a marketing strategy.⁸⁰ The orientation session gives group members the opportunity to question each other about business ideas and effectively analyze loan proposals from other group members. Extensive training and technical assistance is not provided. Using this minimalist approach to training, the Fund seeks to capitalize on the prospective borrower's existing skills and activities.

After completion of the orientation session and approval by the Fund as an official borrowing group, the Circle members meet every two weeks to discuss and analyze their business and expansion plans, make decisions regarding individual borrow-

75. *See id.*

76. *See* WOMEN'S SELF-EMPLOYMENT PROJECT, FACT SHEET, FULL CIRCLE FUND 1 (1991).

77. *See id.*

78. *See id.* at 2.

79. *See id.* at 1.

80. *See id.*

ing requests, and receive loans and make repayments.⁸¹ The group members also lend the necessary emotional support to individuals whose business is in the transition stage from an idea to a reality.

The Circle has evolved a standard format for borrowing and repaying loans.⁸² The interest rate on one-year loans is 15%.⁸³ Circle members use the trust of their fellow Circle members as collateral for their loans. After the Circle members attend the orientation sessions and create a certified group, the Circle selects two members to receive the first loans.⁸⁴ The group members review the loan proposals and make the loan decisions. In other words, the group serves as a "loan committee."

A borrower begins to repay the loan two weeks after receiving it, and repays it in twenty-six payments, or one payment every two weeks.⁸⁵ To bolster the likelihood of repayment, the Circle requires that within one month of receiving a loan, a borrower must use the funds for business purposes and show the group receipts for business purchases.⁸⁶ Group members are eligible for future loans only if all borrowers in a circle are current on their loan repayments. If one member of a group defaults, the others lose their access to future borrowing.⁸⁷ After the first two members make their loan repayments at meetings over a two-month period, the third and fourth members become eligible for loans.⁸⁸ If all four members consistently make repayments for another two months, the fifth group member becomes eligible for a loan.⁸⁹

The Circle also collects deposits for each member's savings account, called an Enterprise Account.⁹⁰ The Circle determines the amount of the bi-weekly deposit that the members must make into this account. Each borrower also contributes five percent of her loan amount to the Circle's Emergency Fund.⁹¹ Circle members decide how to use the Emergency Fund. They

81. *See id.*

82. *See GELLATLY, supra* note 69, at 7. The Fund loans up to \$1,500 to first-time borrowers. *See id.*

83. *See WOMEN'S SELF-EMPLOYMENT PROJECT, supra* note 76, at 2.

84. *See id.*

85. *See GELLATLY, supra* note 69, at 7.

86. *See WOMEN'S SELF-EMPLOYMENT PROJECT, supra* note 76, at 2.

87. *See id.*

88. *See id.*

89. *See id.*

90. *See GELLATLY, supra* note 69, at 8.

91. *See id.*

may, in theory, use it for any purpose, but the fund is intended for business-related expenditures, such as group insurance, an emergency loan to a group member, or as a source of additional funds for a member's business.

While it is premature to assess the success of the Fund, as of 1990, no borrower had defaulted.⁹² The Fund's group-borrower strategy allows peer pressure and group support to replace bank collateral. Furthermore, the peer groups enable participants to network with other business owners, thereby reducing the isolation of self-employment.⁹³

B. *Obstacles to Microenterprise Efforts in Urban America*

The Fund has utilized the Grameen Bank model in providing loans to impoverished females. There are, however, obstacles in adapting that model to urban America. These obstacles include (1) the small percentage of potential entrepreneurs; (2) an alleged lack of informal markets; (3) problems of long-term viability; (4) legal barriers; and (5) geographic and societal impediments.

First, skeptics argue that only a small percentage of inner-city residents are risk-oriented.⁹⁴ These critics contend that the microenterprise model does not provide a viable, long-term approach to overcoming dependency and poverty, because it is inappropriate for vast numbers of persons. Small-scale enterprises in America will not achieve the impact on income and savings that has been achieved in the Third World.⁹⁵

It must be noted that we do not actually know how many individuals possess the skills and potential to become self-employed. We do know, however, that the spirit of enterprise currently is alive and well in the inner-city—albeit in the form of drug trafficking. Is it possible to channel this nascent entrepreneurial culture to more constructive ends?

If even a small percentage of inner-city residents form

92. See Cohen, *supra* note 26, at 11.

93. See A Report on the Development and First Three Years of Operations of the Full Circle Fund: The Grameen Bank Adapted Group Lending Loan Program Model of the Women's Self-Employment Project, Inc., at 20-21 (Aug. 31, 1991) (unpublished paper on file with author).

94. See Martha Mangelsdorf, *Against the Odds, Inc.*, Aug. 1991, at 22, 22-23; Linda Moffat, *The Self-Employment Debate: Responding to the Critics*, in *THE SELF-EMPLOYMENT STRATEGY: BUILDING THE NEW ECONOMY* 53, 54 (1988).

95. See Cohen, *supra* note 26, at 11.

microenterprises, the social utility of these ventures is multi-fold. Self-employment provides economic and social benefits for individuals, families, and communities. Entrepreneurial development creates the potential for increasing the income and wealth of an individual and his family. Self-employment facilitates the development of a number of personal assets, such as leadership ability, personal and business self-confidence, and economic literacy. The availability of loan funds and accompanying training expands borrowers' choices. As inner-city individuals move into new activities, they have the opportunity to take risks and develop in ways that society has presumed are beyond their grasp.⁹⁶ The children of entrepreneurs are exposed to the role model of the small business owner, rather than the social worker or government bureaucrat who, while motivated by compassion, often perpetuates dependency by imposing restrictive controls over the lives of the poor. Proximity to microenterprises can help individuals in inner-city areas, especially children, become aware of the existence of other options and opportunities. In acknowledging their opportunity to choose these options, individuals realize that they have some control over their lives.⁹⁷

The new entrepreneur assists in rebuilding the economy of the low-income neighborhood where she lives and works. Creating local business enterprises produces a positive impact on the community by giving residents a greater stake in their community and its future.⁹⁸ Creating an entrepreneurial culture in America's inner cities can empower individuals, enhance their capacity to change their perceptions and expectations about themselves, and create a demand for new options from the institutions and people around them.

Critics of the microenterprise model argue that most U.S. cities have inadequate informal markets for goods and services, so that microenterprise economic development is doomed from the start.⁹⁹ Specifically, these skeptics argue that home-based businesses in U.S. cities face competition from larger entities and businesses with storefront locations.

Despite the presence of established, large-scale businesses,

96. See *Business Scene: The New Surge in Self-Employed*, N.Y. TIMES, Jan. 15, 1991, at D2.

97. See Moffat, *supra* note 94, at 56.

98. See *id.* at 57.

99. See, e.g., Cohen, *supra* note 26, at 10.

marketing niches for microenterprises in U.S. urban areas exist. An unmet demand exists for goods and services in a variety of areas, including home repair, painting, electrical services, plumbing, carpentry work, and small appliance repair; child and elder day care; health and environmental services; computers and information services; clothing manufacturing and repair; and crafts and foods services such as catering and specialty foods.¹⁰⁰

Inner-city residents possess the ability to organize a successful sales network among friends, relatives, neighbors, and members of religious institutions. In addition, microenterprise lenders can assist new ventures in developing marketing strategies, linking complementary businesses, and implementing collective work arrangements.¹⁰¹ Although marketing in the U.S. generally requires a high level of sophistication, inner-city dwellers should be able to develop a wide array of goods and services to substitute for those imported into urban areas as well as for export outside the inner city.

Studies indicate that opportunities exist to create or expand viable enterprises with a small amount of capital.¹⁰² For example, in a statewide survey of female business owners in Maine, 29% of the respondents started their businesses with less than \$1,000 and another 26% started with between \$1,000 and \$5,000.¹⁰³ Access to relatively small amounts of capital can enable individuals to overcome a significant barrier to starting or expanding a business.¹⁰⁴

Microenterprise development can also enhance opportunity for those who do not choose the long-term path of self-employment. Self-employment income can supplement wages from jobs.¹⁰⁵ Even for individuals who lack a regular job or a two-

100. See generally U.S. DEPT. OF COMMERCE, 1990 U.S. INDUSTRIAL OUTLOOK (Jan. 1990) (documenting potential opportunity in these and other markets); U.S. SMALL BUSINESS ADMINISTRATION, REPORT OF THE PRESIDENT: THE STATE OF SMALL BUSINESS 14 (1988) (reporting growth in retail, food, health and other industries during 1987-1988 period).

101. See Rona Feit, *The U.S. Experience*, in THE SELF-EMPLOYMENT STRATEGY: BUILDING THE NEW ECONOMY 39-40 (1988) (emphasizing the need for microenterprise lenders to create linkages with other community resources).

102. See *Creating an Entrepreneurial Culture*, *supra* note 9, at 3-4.

103. See *id.*

104. See *id.*

105. See SANDRA SCHEINFELD, WOMEN'S SELF-EMPLOYMENT PROJECT, FINAL REPORT ON THE INDEPENDENT BUSINESS WOMEN DEMONSTRATION PROGRAM 1 (Oct. 1989). An analysis of the Independent Business Women Demonstration Program, a self-employment program in Chicago, indicates that 70% of the participants are currently off wel-

income household, access to credit provides a stepping stone to economic advancement. The experience of starting a microenterprise and repaying a loan improves an individual's readiness for the responsibilities of salaried employment. Successful participation in a borrowing group enables individuals to establish or improve their credit history by demonstrating the ability to manage a business and repay debt.

Federal, state, and local laws and regulations often serve as obstacles to the development of microenterprises. Barriers to self-employment include (1) Aid to Families with Dependent Children welfare regulations; (2) public housing rules and regulations for housing subsidies to low-income individuals; and (3) municipal limitations or prohibitions on home-based businesses.

In 1935, the Aid to Families with Dependent Children (AFDC) Program¹⁰⁶ was adopted as part of the Social Security Act to enable single parents to remain out of the workforce and fulfill their domestic responsibilities.¹⁰⁷ Gail C. Christopher, who provides the analysis upon which this section relies, has concluded that AFDC regulations, especially asset level, health insurance, and child care provisions, make the transition from welfare dependency to economic self-sufficiency difficult.¹⁰⁸ Current asset and income limits render an AFDC recipient's prospect of economic independence through self-employment virtually impossible, because individuals receiving AFDC lose their eligibility when they accumulate more than \$1,000 in personal assets.¹⁰⁹ By not distinguishing between business and personal assets, the \$1,000 asset limit discourages business start-ups.¹¹⁰ Furthermore, in computing the \$1,000 asset limit,

fare thereby resulting in an average savings to the Illinois Department of Public Assistance of \$2,655 per year per participant. *Id.* at 1, 34. Fifteen percent of the participants (three of twenty) were able to support their families solely from business activities within a one-year period. *Id.* at 2.

106. Aid to Families with Dependent Children Act, ch. 531, Title IV, § 401, 49 Stat. 627 (1935) (codified as amended at 42 U.S.C. §§ 601-615 (1988)).

107. Social Security Act, 42 U.S.C. §§ 601-602 (1988). For an analysis of AFDC, see Joel F. Handler, *The Transformation of Aid to Families with Dependent Children: The Family Support Act in Historical Context*, 16 N.Y.U. REV. L. & SOC. CHANGE 457 (1987-88).

108. See generally GAIL C. CHRISTOPHER, WOMEN'S SELF-EMPLOYMENT PROJECT, ILLINOIS PUBLIC AID POLICY BARRIERS AND DISINCENTIVES TO THE SELF-EMPLOYMENT INITIATIVE OF THE AFDC RECIPIENT (1986).

109. See 45 C.F.R. § 233.20(a)(3)(B) (1990). In addition, under federal regulations, the equity (fair market value minus encumbrances) in an automobile owned by an AFDC recipient cannot exceed \$1,500. See *id.*

110. See CHRISTOPHER, *supra* note 108, at 3.

state AFDC regulations may bar deductions for depreciation on equipment or other business property or payments of principal on loans used to obtain capital equipment or durable goods.¹¹¹ Replacement of existing stock is an allowable expense, but expansion-related inventory expenditures are not recognized.¹¹² States generally authorize some business deductions including accounting fees, rent, utilities, and advertising, as well as equipment leasing fees. Thus, AFDC recipients are often forced to lease their business equipment.¹¹³ Because legal fees, payments on loans to buy equipment, travel costs, inventory expansion, and auto repair expenses generally are not considered before an AFDC grant is reduced, AFDC reduces chances for gainful self-employment.¹¹⁴

Some changes in the criteria for determining AFDC eligibility are needed before microenterprises and self-employment can flourish. To permit the AFDC recipient to terminate welfare dependency more easily, the \$1,000 asset limit should be increased.¹¹⁵ The cap that precludes borrowing working capital or buying equipment and inventory for a microenterprise should be raised. States should also emulate the Internal Revenue Code and permit a depreciation allowance for equipment in determining the value of a small business.¹¹⁶ Self-employed individuals may also require an automobile for business purposes. The \$1,500 cap limits an AFDC recipient's ability to own or buy a car suitable for regular use in business activities.¹¹⁷

AFDC rules also contain stringent income-eligibility levels. In determining an AFDC recipient's income level, federal law

111. *See id.* at 4.

112. *See id.*

113. *See id.* at 10.

114. *See* 45 C.F.R. § 233.20 (g)(6)(v)(B) (1990). This regulation provides that: For AFDC, with respect to self-employment the term "earned income" means the total profit from business enterprise, farming, etc., resulting from a comparison of the gross receipts with the "business expenses," i.e., expenses directly related to producing the goods or services and without which the goods or services could not be produced. However, items such as depreciation, personal business and entertainment expenses, personal transportation, purchase of capital equipment and payments on the principal of loans for capital assets or durable goods are not business expenses.

Id.

115. *See, e.g.*, H.R. 5918, 101st Cong., 2d Sess. (1990) (introduced by Congresswoman Cardiss Collins (D-Ill.)) (proposing that income from a family member attributable to a commercial enterprise with five or fewer employees, one or more of whom owns the enterprise, be disregarded for one year in determining aid eligibility).

116. *See* I.R.C. § 168 (1988); *see also* CHRISTOPHER, *supra* note 108, at 11.

117. *See* CHRISTOPHER, *supra* note 108, at 4.

mandates disregarding a flat monthly amount, the "standard disregard," of \$90 to cover all work-related and business expenses such as transportation, clothing, travel, and parking.¹¹⁸ Most self-employed persons would appear likely to need more than \$90 per month to cover the costs of transportation, auto repairs, and clothing.¹¹⁹ An AFDC recipient can disregard, net of the standard disregard, an additional \$30 per month plus one-third of the remainder of the earned income for such month before calculating the AFDC grant.¹²⁰ After a four-month transition period, AFDC benefits drop one dollar for each dollar of earnings above a set limit.¹²¹ In forty-nine states, "a family of three with a member who has worked for more than four months becomes ineligible for AFDC at an income that is below the poverty level;" in three-quarters of these states "a family would become ineligible at an income that is below 75 percent of the poverty level."¹²²

For AFDC recipients the possibility of self-employment also carries the threat of losing Medicaid and child care benefits, because termination of AFDC often results in termination of Medicaid.¹²³ Microenterprises generally do not generate sufficient income for an entrepreneur to purchase private health insurance to replace Medicaid. To meet this gap, the Family Support Act of 1988 provides transitional Medicaid coverage for twelve months after AFDC payments cease because of employment.¹²⁴ The Family Support Act of 1988 also requires a

118. 42 U.S.C. § 602(a)(8)(A)(ii) (1988).

119. See CHRISTOPHER, *supra* note 108, at 13.

120. 42 U.S.C. § 602 (a)(8)(A)(iv) (1988). *But see* 42 U.S.C. § 602 (a)(8)(B)(ii)(I) (1988) (providing that the recipient loses the right to disregard the \$30 per month if the recipient has already disregarded this amount for twelve consecutive months while receiving AFDC aid, and that the recipient loses the right to disregard the one-third remainder if the recipient has disregarded this amount for four consecutive months while receiving AFDC).

121. 42 U.S.C. §§ 602(a)(8)(B)(ii)(I), 602(a)(7) (1988); see KATHRYN H. PORTER, CENTER ON BUDGET AND POLICY PRIORITIES, MAKING JOBS WORK: WHAT THE RESEARCH SAYS ABOUT EFFECTIVE EMPLOYMENT PROGRAMS FOR AFDC RECIPIENTS 4 n.3 (Mar. 1990).

122. PORTER, *supra* note 121, at 4.

123. See Timothy J. Casey, *The Family Support Act of 1988: Molehill or Mountain, Retreat or Reform?*, 23 CLEARINGHOUSE REV. 930, 938 (1989).

124. The continuation of Medicaid for up to twelve months is divided into two six-month periods. During the first six-month period, the Medicaid coverage continues, without an income test or payment for the coverage premium. In the second six-month period, an earnings-based income test comes into existence and the states may charge a premium for coverage and have the option to eliminate most non-acute care benefits. 42 U.S.C. § 1396f-6 (1988). See Casey, *supra* note 123, at 931, 938-39; CONGRESSIONAL BUDGET OFF., WORK AND WELFARE: THE FAMILY SUPPORT ACT OF 1988 (Jan. 1989); see

state to "guarantee" child care for twelve months "after a family loses AFDC eligibility because of employment or income," subject to a fee requirement, "provided the child care is needed for the parent's continued employment."¹²⁵

Despite these statutory or regulatory changes, affordable health insurance remains a problem for individuals who rely on self-employment as their primary source of income. In a self-employment demonstration project for welfare recipients in Illinois, none of the recipients relying on self-employment as their primary means of support could obtain affordable health insurance.¹²⁶ To reduce this barrier to self-employment, microenterprise lenders should explore the possibility of using the group savings account as a mechanism to fund group health insurance coverage.

Revising welfare rules to promote self-employment for welfare recipients may help decrease poverty. Federal welfare regulations pose barriers to welfare recipients who are interested in pursuing self-employment. The Family Support Act of 1988 removed some impediments to self-employment, particularly by allowing for longer extensions of Medicaid and child care assistance for recipients of AFDC who lose their eligibility because of increased income levels.¹²⁷ A number of barriers remain, however, including limitations on income and accumulation of assets,¹²⁸ limits on the deductibility of certain business expenses,¹²⁹ and requirements that recipients participate in non-self-employment related formal work and training programs.¹³⁰ In short, the present rules make it difficult for a single parent to formalize self-employment activities.

Public housing regulations also contain stringent income-eligibility rules. For example, the Housing Act of 1937¹³¹ pro-

also H.R. 5918, *supra* note 115 (proposing a one-year extension of Medicaid benefits for individuals otherwise ineligible as a result of income attributable to participation in a commercial enterprise with five or fewer employees, one or more of whom owns the enterprise).

125. 42 U.S.C. § 602(g)(1)(A)(ii) (1988). The guarantee of transitional child care benefits expires on September 30, 1998. 42 U.S.C. § 1396r-6(f) (1988).

126. *See* SCHEINFELD, *supra* note 105, at 39.

127. *See* Casey, *supra* note 123, at 938-39.

128. *See* 45 C.F.R. § 233.20(a)(3)(B) (1990).

129. *See* 45 C.F.R. § 233.20(g)(6)(v)(B) (1991); *supra* notes 108-114 and accompanying text.

130. *See* Casey, *supra* note 123, at 935; PORTER, *supra* note 121 (outlining training programs).

131. 42 U.S.C. § 1437-1440 (1988).

vides housing assistance payments to participating owners on behalf of eligible "very low-income" families at rents they can afford.¹³² "Very low-income families" are defined as those families "whose income[] do[es] not exceed 50 percentum of the median family income for the area, as determined by . . ." the Housing and Urban Development Agency (HUD) with adjustments for smaller and larger families.¹³³ The Housing Act also offers public housing for "low income families,"¹³⁴ defined as those families whose income does not exceed 80% of the HUD-determined median income for the area.¹³⁵ "Income" comprises income from all sources of each household member,¹³⁶ and includes the net income from operations of a business or profession.¹³⁷ Expenditures for business expansion or amortization of capital indebtedness cannot be used as deductions in determining net income.¹³⁸ A family that exceeds the income limits loses the subsidy or the ability to occupy a public housing unit. Program administrators, as well as local housing authorities, must implement transitional eligibility standards to enable individuals to make the progression from dependency to economic self-sufficiency.

Municipalities limit or prohibit home-based businesses mainly through zoning practices. Home-occupation ordinances regulate potential abuses such as unregulated hours, poor working conditions, child labor, wage exploitation, and lack of benefits, and also ban nontraditional home businesses.¹³⁹ The ordinances typically confine the home business to a limited percentage of the residential space, limit the number of nonresident employees, and restrict the type and size of equipment used.¹⁴⁰

Such restrictions, however, impede microenterprises. Low-income persons necessarily start their businesses at home to curb start-up costs. A restriction such as the traditional-use requirement hinders innovative entrepreneurship, while restric-

132. See 42 U.S.C. § 1437f(o) (1988).

133. 42 U.S.C. § 1437a(b)(2) (1988).

134. 42 U.S.C. § 1437-1440 (1988).

135. 42 U.S.C. § 1437a(b)(2) (1988).

136. 42 U.S.C. § 1437a(b)(4) (1988).

137. 24 C.F.R. § 813.106 (1990).

138. See *id.*

139. See JOANN BUTLER & JUDITH GETZELS, AMERICAN PLANNING ASS'N, HOME OCCUPATION ORDINANCES 9 (1985).

140. See *id.* at 12.

tions on equipment may frustrate microentrepreneurs in the mechanic or food industries. Although a fear of "sweatshop" home-based industry may be valid, particularly in the clothing trades, local governments should reconsider and remove municipal obstacles that impede home-based small business development.

The geographic and societal impediments to establishing viable microenterprise lending programs should not be underestimated. Problematic contrasts exist between the impoverished in the Third World and in America's inner cities. High population density and a homogeneity of borrowers may underpin the Grameen Bank's success.¹⁴¹ Additionally, communities in Bangladesh are very stable and the borrowers share a common cultural and social background.¹⁴²

In U.S. cities, however, borrowers may be spread out geographically. A low concentration of borrowers hampers the high borrower-to-staff ratio that reduces transaction costs for the Grameen Bank.¹⁴³ To mitigate this problem, borrower groups must be clustered in specific inner-city neighborhoods. The multicultural nature of urban neighborhoods, however, may render difficult the organization of Grameen-style centers, that is, clusters of borrowing groups.¹⁴⁴ The centers are a key aspect of the Grameen approach because they facilitate cost-effective lending by reducing administrative costs and also provide the "structural basis for efficient grassroots banking and for community development activities."¹⁴⁵

In addition to the difficulty of finding a location for center meetings, U.S. borrower groups may resist the idea of meeting at a center with other groups, preferring smaller, closely-knit support groups; mixing groups with different ethnic compositions from diverse neighborhoods encounters resistance from borrowers.¹⁴⁶ Thus, doubts exist about the applicability of the center structure to urban America, specifically whether the center structure facilitates the attainment of two objectives: creating a supportive environment for borrowers and increasing

141. See Cohen, *supra* note 26, at 9.

142. See *id.*; see also HOSSAIN, *supra* note 18, at 81.

143. See Cohen, *supra* note 26, at 9.

144. See *id.*

145. *Id.*

146. See WOMEN'S SELF-EMPLOYMENT PROJECT, GROUP LENDING EXCHANGE: JANUARY 1990 WORKSHOP REPORT 6 [hereinafter GROUP LENDING EXCHANGE].

loan repayment rates.¹⁴⁷

IV. ADAPTING MICROENTERPRISE LENDING TO THE AMERICAN URBAN UNDERCLASS

A considerable degree of cultural diversity characterizes many U.S. inner cities. In areas with public housing, single women with children have relocated from different parts of the city and maintain networks of relatives and friends in their old neighborhood.¹⁴⁸ These factors may make it difficult to establish stable, geographically-proximate borrower groups, consisting of individuals who know and trust each other. To overcome these cultural and geographical barriers, as well as the anonymity of modern urban America, enterprise agents, or outreach workers, must devote additional time and energy to organizing stable borrower groups.

As indicated above, microenterprise lending staff members, or enterprise agents, play a significant role in the formation of borrower groups. If the peer group process is premised in part on the group's integral role in loan planning and monitoring, the group members must be active "players." Peer group members may be reluctant to confront their peers and may not question a faulty proposal even if they perceive a problem with it. The lender enterprise agent should encourage group members to critique entrepreneurial ventures and to ask tough questions of each other. Well-structured orientation sessions should give the group practice in asking these tough questions.¹⁴⁹ In addition, the lender may consider creating a loan review committee, consisting of lender staff or of another group of borrowers, who assist the group in reevaluating certain loan decisions. The loan review committee will strive to illuminate any issues the group has not yet addressed, facilitating group confrontation of those issues.¹⁵⁰

If the key aim of the center concept is to reduce administrative costs while operating within the realities of urban America, microenterprise lenders must find an alternative to bi-weekly meetings at one central location. In many cities it may be difficult to find a suitable location for a center. Also, borrowers may

147. *See id.*

148. *See* Cohen, *supra* note 26, at 9.

149. *See* GROUP LENDING EXCHANGE, *supra* note 146, at 7.

150. *See id.* at 8.

oppose the concept of a meeting at a center with other groups.¹⁵¹ Alternatives include alternating between bi-weekly group meetings and center meetings, permitting a borrower group to conduct bi-weekly meetings on its own to establish a good working relationship between group members and to demonstrate their viability as a group before the group becomes part of a center, replacing the bi-weekly center meetings with regular meetings of group chairs and giving them additional powers, or replacing the bi-weekly center meetings with quarterly or semi-annual general meetings (being cognizant of ethnic and community factors) to provide networking opportunities.¹⁵² In the case of the last three alternatives, the circle chair would collect funds and bring them to a central repayment location.¹⁵³ Alternatively, groups could be given the option of gathering around ethnic and community lines in a central meeting location or meeting separately.

Beyond questions concerning the viability of the center concept, the importance of workable borrowing groups, which take a long time to form, cannot be underestimated. Group members should share the same expectations about the required level of participation. Good groups communicate effectively and address sensitive issues in their orientation process.¹⁵⁴

V. THE PRIVATE, PUBLIC, AND NONPROFIT SECTORS' ROLE IN MICROENTERPRISE LENDING

Even if the obstacles outlined above are surmountable, various structural, capital, and urban problems must be addressed before microenterprises can blossom in the inner cities. Effective solutions to the pervasive and complex problems in the inner city will require extensive efforts from both public and private sector institutions.

The structure of a microenterprise program must account for the attendant problems facing its borrowers. Because of the greater sophistication required of entrepreneurs in the United States relative to lesser-developed countries, more efforts should be focused on pre-loan education and training. For example, at the Micro Enterprise Capital Corporation in Wash-

151. See Cohen, *supra* note 26, at 9.

152. See GROUP LENDING EXCHANGE, *supra* note 146, at 6.

153. See *id.*

154. See *id.* at 5, 36.

ington, D.C., the first for-profit micro-bank in North America, prospective borrowers must complete a three-month series of courses in budgeting, finance, and marketing.¹⁵⁵ When providing this training, the microenterprise lender should adjust the program to the particular conditions facing the borrower. For example, the Workshop for Business Opportunities in New York provides not only technical instruction, but also self-enhancement training for minority entrepreneurs.¹⁵⁶ The public sector could offer assistance in this area. For instance, publicly-supported educational institutions could provide free entrepreneurship classes, and publicly-sponsored programs could furnish technical assistance to both the borrower and the counselor.¹⁵⁷

Through coordination with community organizations and networks, microenterprise lenders will be able to achieve a greater, more cost-effective volume of borrowers while simultaneously addressing the educational, vocational, and social service needs of the target population. For example, linking microenterprise loan programs to a literacy program would provide an incentive for potential borrowers to enroll in the literacy program, and participation in a group-oriented literacy program could promote receptivity to the peer group lending approach. Other community organizations could similarly redefine or adjust their services to facilitate microenterprise economic development. Assuming the necessary structural adaptations could be achieved, lenders must obtain additional capital for these loan programs. Public sector organizations, such as the United States Small Business Administration, could create their own microenterprise lending programs¹⁵⁸ or provide funds to microenterprise lenders. Furthermore, commercial banks should provide funds or loan guarantees. Bank involvement not only expands the capital pool and improves bank familiarity with the capabilities and needs of microenterprises, but also provides other advantages, such as the development of a lasting business relationship between the client and a

155. See *Micro Bankers Help the Poor Make Money*, N.Y. TIMES, Sept. 3, 1990, § 2, at 28.

156. See Leon E. Wynter, *Workers are Helping Blacks Become Entrepreneurs*, WALL ST. J., Dec. 19, 1990, at B2.

157. Group lending practitioners should engage in workshops that serve as informational sharing sessions. See, e.g., GROUP LENDING EXCHANGE, *supra* note 146.

158. See, e.g., Jeanne Saddler, *Small SBA Loans Planned to Put the Poor in Business*, WALL ST. J., Dec. 14, 1990 at B2 (describing a proposed pilot program).

commercial bank. Indeed, as a bank develops ties to a greater number of entrepreneurs, its commitment to revitalize the inner-city community will increase, thereby extending the benefits of the program beyond the individuals directly involved. To facilitate commercial bank involvement, the public sector should create microenterprise loan guarantee funds to reduce the risks faced by commercial banks.¹⁵⁹ For example, the Small Business Administration could be authorized to provide loan guarantees to commercial banks that make loans to microenterprise lenders. Because the microenterprise lending programs are of a revolving nature and likely will experience a very low default rate, the likelihood of the guarantees being tapped is slight.

Microenterprise loan programs should also consider three further goals. First, micro-bankers should consider a social development program designed to motivate group members.¹⁶⁰

159. The Commerce, Justice, State, Judiciary, and Related Agencies Appropriation Act, Pub. L. No. 102-140, § 609(h), 105 Stat. 782, 827-31 (1991).

160. See generally Anis Ahmed, *Rural Bank Takes Economic Reform to Bangladesh Villages*, Reuter Library Rep., Dec. 26, 1989; Tempest, *supra* note 20, at 22-23. The Grameen Bank has such a program, known as the "Sixteen Decisions." The Sixteen Decisions are as follows:

1. The four principles of Grameen Bank—Discipline, Unity, Courage and Hard Work—We shall follow and Advance in all walks of our lives.
2. Prosperity we shall bring to our families.
3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.
4. We shall grow vegetables all the year round. We shall eat plenty of it and sell the surplus.
5. During the plantation seasons, we shall plant as many seedlings as possible.
6. We shall plan to keep our families small. We shall minimise [sic] our expenditures. We shall look after our health.
7. We shall educate our children and ensure that they can earn to pay for their education.
8. We shall always keep our children and the environment clean.
9. We shall build and use pit latrines.
10. We shall drink tubewell water. If it is not available, we shall boil water or use alum.
11. We shall not take any dowry in our sons' wedding, neither shall we give any dowry in our daughters' wedding. We shall keep the centre free from the curse of dowry. We shall not practice child marriage.
12. We shall not inflict injustice on anyone, neither shall we allow anyone to do so.
13. For higher income we shall collectively undertake bigger investments.
14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him.
15. If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline.
16. We shall introduce physical exercise in all our centres. We shall take part in all social activities collectively.

Second, micro-bankers should consider incorporating personal effectiveness training into group sessions to assist borrowers in dealing with alcohol or drug problems and in setting achievable personal goals. Third, micro-bankers should give special consideration to allocating credit to teenagers and individuals in their early twenties to instill a sense of responsibility and self-sufficiency early in life.

Microenterprise loans address a significant aspect of an inter-related web of decay and despair. Entrepreneurs can help produce a renaissance of the inner city, but entrepreneurship by itself is not likely to fully displace a pervasive welfare culture that is nearly sixty years old. Innovative responses, however, may surmount the legacy of dependence. A partnership of private development banks, public sector reforms, and public and private training endeavors can further this process. The private financial sector has the potential to significantly contribute to and complement microenterprise loan programs. Privately-owned banks, such as the Shorebank Corporation in Chicago and the Southern Development Bancorporation in Arkansas, serve as models for economic development programs, and demonstrate the job-creating potential of bank holding companies.¹⁶¹ These banks extend credit to locally-owned and operated businesses and support the low-income community through housing loans.¹⁶² For example, Shorebank has succeeded in stemming the decline of Chicago's South Shore neighborhood through a program of loans to increase home ownership and rehabilitate apartment buildings occupied by low-income and middle-income individuals.¹⁶³ Estimates indicate that Shorebank's loans led to the rehabilitation of approximately one-third of the South Shore's buildings.¹⁶⁴ Furthermore, crime has decreased in the South Shore neighborhood and the black middle class is staying. Entrepreneurs who renovated the apartment buildings financed by Southbank

GROUP LENDING EXCHANGE, *supra* note 146, Appendix.

161. See *Capitalist Tool: The Good Faith Fund*, N.M. BUS. OPPORTUNITY NEWS, Aug. 1988, at 6.

162. See *id.*; see also *Development Banking: Giving Credit Where Credit is Overdue*, FORD FOUND. LETTER (Ford Found.), Nov. 1989 [hereinafter FORD FOUND. LETTER]; SOUTHERN DEV. BANCORPORATION, *THE ARKANSAS DEVELOPMENT BANK* (1988).

163. See David Osborne, *Bootstrap Banking*, INC., Aug. 1987, at 69, 70.

164. See *id.*

serve as "gatekeepers" for the community.¹⁶⁵

Other functions performed by a bank holding company include managing a technical assistance arm to provide business services such as accounting, marketing, and planning to borrowers.¹⁶⁶ Through a real estate development subsidiary, a holding company can also function as a real estate developer, assembling land and developing properties for use as business incubators, as well as providing low-income and moderate-income housing.¹⁶⁷ A venture capital arm can provide equity investments in larger locally-owned firms, and seed capital for loans to new and expanding businesses.¹⁶⁸

Chicago's Shorebank has made great strides toward developing a comprehensive approach to microenterprise development. As one observer notes, "Shorebank demonstrates the power of combining the investment methods of the private sector with the social goals of the public sector."¹⁶⁹ Obstacles, however, remain. Private banks must attract development deposits from institutions and wealthy investors who support community renewal programs.¹⁷⁰ Shorebank has not proven sufficiently profitable to convince others to imitate its successes. Consequently, there may be a need for the public sector to take on the role of equity investor in private development banks and to allocate access to government deposits in order to provide access to lower-cost capital.¹⁷¹

165. See David Osborne, *A Poverty Program that Works*, THE NEW REPUBLIC, May 8, 1989, at 25.

166. See THE NEIGHBORHOOD INST., ORGANIZATIONAL DESCRIPTION 3; see also Osborne, *supra* note 165, at 24.

167. See, e.g., THE NEIGHBORHOOD INST., *supra* note 166. The Neighborhood Institute, a nonprofit affiliate of Shorebank operates a low-income and moderate-income housing development program that includes technical assistance, tenant organization, and housing referrals.

168. See Osborne, *supra* note 165, at 22; see also David Osborne, *supra* note 163, at 69, 70.

169. Osborne, *supra* note 165, at 22, 25. Another example of this combination is the Arkansas Enterprise Group (Group), a nonprofit affiliate of the Southern Development Bancorporation (Southern). Southern is a specialized bank holding company (launched in part by Shorebank) that funds the Group's microenterprise loan fund, known as the Good Faith Fund. This fund utilizes peer group organization to finance self-employment ventures for low-income persons without collateral. Southern presents a model of private banking's role in remedying social ills through economic development. SOUTHERN DEV. BANCORPORATION, *supra* note 162. See generally THE GOOD FAITH FUND, FACT SHEET (1990) (outlining borrower group formation, training, and loan operation); FORD FOUND. LETTER, *supra* note 162, at 4; Toni Y. Joseph, *Faith, Hope, and Money*, DALLAS MORNING NEWS, Apr. 15, 1990, at F1.

170. See Osborne, *supra* note 165, at 24.

171. See Osborne, *supra* note 165, at 23.

Entrepreneurial development programs can attack social problems, but the challenge is far broader than self-employment, access to credit, and peer support. Human reconstruction rests on three principles. First, policies should be based on old-fashioned, but often neglected values, such as responsibility for one's self and one's community, pride, hope for the future, and a work ethic.¹⁷² Second, society must discard or modify institutions and legal rules and regulations that restrict individual initiative. Money, particularly public sector credit and investment, should be steered to entrepreneurs who will provide jobs not only for themselves, but also for other inner-city residents. Third, self-help and the development of communities from within rests on involving people with the process. By keying policies to the values of responsibility, empowerment, control over one's life and human growth, the resurgence of America's inner cities can occur.

172. See STEELE, *supra* note 6.

