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# Escaping from the poverty trap with social innovation: a social microcredit programme in Hungary

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# Escaping from the poverty trap with social innovation: a social microcredit programme in Hungary

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# Escaping from the poverty trap with social innovation: a social microcredit programme in Hungary

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## Abstract

This paper describes a Hungarian social microcredit programme, called Kiútprogram and discusses the major lessons drawn from its operation. It was launched some 10 years ago as an adaptation of the Grameen model to the Hungarian circumstances to decrease the level of prejudice and discrimination against the Roma and improve their living conditions in the most remote, deprived areas of Hungary; microlending has been understood and introduced as a device to achieve these aims – and not as a profit-seeking business activity.

During the almost ten-year long learning process, from the simple adaptation of the Grameen model the Kiútprogram has arrived to the denial of the most important features of joint liability in group lending, namely the application of the devices of social collateral. Experience has also shown that a loan itself is not sufficient to assist escaping from the poverty trap. Without knowledge transfer and without inter-community connection building – at least in the case of discriminated minorities – the effect of the loan may even be detrimental. In a modern society not only physical, but also social and cultural capital is needed to run a successful business in the formal sector of the economy.

In the Kiútprogram's model the loan plays a crucial role in escaping from the aspiration trap, and thus helps overcome learned helplessness. Loans without any – financial or social – collateral signal that the lender trusts the client, not only in her honesty, but also in her abilities. This method of lending strongly suggests to the clients the conviction that she is able of achieving a business success. Neither financial aid, nor loan with (social) collateral is suitable to reach this effect.

**Keywords**: microcredit, group lending, empowerment, poverty trap, aspiration trap, Roma minority

**JEL:** G21, L31, O35, J24, J71

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# Kitörés a szegénységi csapdából: egy magyar szociális mikrohitel program

Molnár György és Havas Attila


## Összefoglaló

Az esettanulmány egy magyar szociális mikrohitelezési program, a Kiútprogram működését és az abból levonható legfontosabb tapasztalatokat ismerteti. A program a Yunus-féle Grameen-modell magyar viszonyokra történő adaptálásaként indult. Elsődleges célja Magyarország távoli, elmaradott területein élő romák életkörülményeinek javítása és a velük szembeni előítéletek csökkentése; a mikrohitelezés ezt elősegítő eszköz és nem üzleti vállalkozás.

A Kiútprogram közel tízéves működése interaktív tanulási folyamatnak tekinthető. Ennek során a Grameen-modell egyszerű adaptációjától fokozatosan jutott el a kölcsönös kötelezettségeken alapuló csoportos hitelezés legfontosabb jellemzőinek, a társadalmi fedezet módszerének elvetéséhez. A program fontos tanulsága, hogy a hitel önmagában nem elégséges a szegénységi csapdából történő kitöréshez. Tudás-transzfer és a közösségközi kapcsolatok elősegítése nélkül – legalábbis a társadalmi megkülönböztetéstől szenvedő kisebbségek esetében – a hitel önmagában akár káros következményekhez is vezethet. Egy modern társadalomban nem csak pénztőke, hanem társadalmi és kulturális tőke is szükséges a sikeres vállalkozáshoz.

A Kiútprogram modelljében a hitel szerepe nem csak a pénzügyi források nyújtása. Központi szerepet játszik az aspirációs csapdából való kitörésben, a tanult tehetetlenség leküzdésében. A fedezet nélküli hitel bizalmat fejez ki az ügyfél iránt. A támogatók és a támogatottak közötti bizalom elengedhetetlen a kedvező hatások eléréséhez. Ezt a bizalmat sem pénzbeli segély, sem fedezethez kötött hitel nyújtásával nem lehet megteremteni.



**Tárgyszavak:** mikrohitelezés, csoportos hitelezés, képessé tétel, szegénységi csapda, aspirációs csapda, roma kisebbség

**JEL kód:** G21, L31, O35, J24, J71

## Köszönetnyilvánítás

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# 1 INTRODUCTION

It is a longstanding debate in economics whether the phenomenon of poverty trap exists, that is, a self-reinforcing mechanism that causes poverty to persist. “When poverty is very extreme, the poor do not have the ability – by themselves – to get out of the mess. (…) There is no margin of income above survival that can be invested for the future.” (Sachs 2005: 56).

The debate around this problem is summarised in Banerjee and Duflo (2011: 12). These analyses assume that present income influences the income in the future, e.g. when someone does not have sufficient income to reproduce his or her labour force then can only earn less – or even nothing – in the following period. Hence, who has once been trapped in poverty, remains in this trap. A sufficiently large initial investment is, therefore, needed to escape from the poverty trap, in the form of external help. In contrast, outside the poverty trap zone, present income is enough to increase income in the future.

If we reject this line of arguments, that is, the poverty trap does not exist, then present income generates higher future income. Moreover, at lower income levels the increase is relatively higher, as the return is diminishing. In this case there is no need for external help. Many economists even claim that external assistance is even harmful (e.g. Easterly 2006). As Banerjee and Duflo (2011: 3–4) summarised the main idea behind this view: aid “prevents people from searching for their own solutions, while corrupting and undermining local institutions (…) When markets are free and the incentives are right, people can find ways to solve their problems. They do not need handouts, from foreigners or from their own government.”

Microlending – providing unsecured loans of relatively small amounts in order to establish income generating ability– is perceived as one of the best solutions to alleviate poverty by the supporters of the anti-aid view. This approach accepts that a small initial investment is needed, but it should be provided in a market-conform way, in the form of loan and not aid.

It is a fundamental question not only from a theoretical but also a practical point of view whether the poverty trap exists: both policy-makers and social innovation practitioners need to devise their strategies and actions by considering the answer to this question. If the poverty trap does not exist, a loan – provided in the form of a microcredit or otherwise – can be sufficient to help escaping from poverty. In contrast, if the phenomenon of poverty trap does exist, loan in itself – regardless of its form and the way, in which it is provided – is not sufficient: it can only be a part of a more complex solution.

Microlending has become a huge and quickly developing industry since the 1970s. It has been praised as one of the most important social innovations to alleviate poverty. Advocates of microcredit see it as the starting point of a revolution in terms of access to banking. More enthusiastic supporters even consider it a source of major social transformation. Marguerite Robinson, in her book characteristically entitled *The Microfinance Revolution* makes a bold claim: “The focus then turns to the recent shift in microfinance from government and donor-subsidized credit delivery programs to financially self-sufficient institutions providing commercial microfinance.” (ibid: xxxvi) Microfinance activities have, indeed, absorbed a significant proportion of development resources both in terms of finances and human capacities.

Serious failures, however, have made it questionable if microlending can be depicted as a success story. The first large microfinance meltdown occurred in 1999, in Bolivia and in the following years a series of other collapses occurred among others in India (Andra Pradesh), Morocco, Nicaragua and Pakistan (Bateman and Chang 2012; Ghosh 2013). These events have prompted a series of statistical analyses to establish whether microlending has had positive impacts. Space limits do not allow a full treatment of these results, but we highlight some outcomes below.

Concerning the case of the Indian SEWA Bank, Duvendack (2010) concludes that “not only do these data and methods not provide support for the idea that microfinance is highly beneficial to the poor, rather than perhaps benefitting a slightly better off group, but it leaves open whether microfinance is of any real benefit at all, since much of the apparent difference between microfinance participants and controls is likely due to differences in their characteristics rather than the intervention *per se*”. (p. 44)

The January 2015 issue of the *American Economic Journal: Applied Economics* was devoted to evaluating the impacts of microcredit programmes run in six different countries (Banerjee et al., Tarozzi et al., Attanasio et al., Crépon et al., Angelucci et al., Augsburg et al.; all 2015). In summary, the papers found a consistent pattern of modestly positive, but not transformative, effects. None of the six studies found robust evidence that the investigated programmes had increased the household income of the participants (Banerjee et al. 2015). It should be stressed, however, that even these modest results should be taken with a pinch of salt, given that these are based on existing microlending activities, while the socio-economic impacts of the collapsed programmes are not factored in.

The sharpest critique on commercialised – profit-seeking – microlending posits that profitable microlending has undermined the long-term fight against poverty (Bateman 2010). This analysis also claims that social microlending undermines the services provided by the state to the poor, takes away the sources from other development possibilities, crowds out from the market already existing microenterprises and its informality may increase vulnerability (Bateman and Chang 2012). Moreover, a detrimental danger has also been identified: social pressure might turn into physical coercion (Ghosh 2013).

Finally, the thorough review of the relevant literature by Banerjee and Duflo (2011) does not give a general answer to the question raised above: does the poverty trap exist? As the authors are firmly against ideological approaches, they recommend analysing the effects of specific policy tools and other solutions by randomised control trials (RCT). They conclude that the phenomenon of poverty trap exists in many – but not all – analysed cases. In their view microlending in itself can be useful, but several problems arise when it is perceived and applied as a *panacea*. It can be a useful financial instrument to generate simple microenterprises and decrease the exposure to loan sharks. The rules of social microlending, however, are too rigid and the repayment period is too short, and hence it can inhibit starting businesses with larger capital intensity. For these reasons it can hinder economic development, taking a macro perspective. Moreover, it can deter those who do not want to either exert or accept peer pressure.

They also stress the importance of psychological factors – besides other causes – in the reproduction of the poverty trap. Psychological research has shown that long-term deprivation itself often leads to *learned helplessness* (Peterson et al. 1993) and this helplessness can be further increased by experiences of discrimination. The feeling 'no matter what I do, it will get worse in the end' may easily become ingrained.

In behavioural economics – partly based on anthropological observations (Appadurai 2004) – a similar situation is described by the notion of *aspiration failure*, that is, the failure to aspire to one's own potential. Poverty lowers the aspiration level and low aspirations result in less or misdirected effort, leading to a *behavioural poverty trap* (Ray 2006, Dalton et al. 2016). Anti-poverty interventions, therefore, should consider this phenomenon. Dalton and Ghosal (2011) distinguishes four possible policy approaches in this respect: direct, indirect and libertarian paternalistic, as well as soft libertarian, which is their proposal. In the first three cases it is supposed that the planner (the planner can be a policy-maker or an actor of an intervention) knows the individual normative preferences of the subject of the intervention. To put it sharp, the planner knows, what is good for you. In the case of direct and indirect paternalism the planner imposes a choice on the subject directly and through taxes or subsidies, respectively. Libertarian paternalism applies the so-called nudging, changing the reference point of the decisions (Thaler and Sunstein 2010, 2013).

The soft libertarian approach uses psychological therapies to raise aspirations. This kind of intervention alone can be sufficient to help escape from a poverty trap, even without relaxing material constrains (Dalton et al. 2016). Yet, in the case of strong objective barriers, stimulating aspirations regardless of their cause may lead to frustration (Flechtner 2017).

Against the backdrop of the debates presented above, we investigate the problem of poverty trap in relation with microlending in this paper, relying on a Hungarian social microcredit programme, called Kiútprogram.[1] The size of the programme is too small for an analysis based on RCT, and we present the almost ten-year history of the programme in a case study. We also confront our observations with some theoretical statements regarding microlending. No doubt, a case study cannot prove theoretical conclusions, but it can pose questions to reconsider some widely accepted theoretical claims or policy approaches. In a more ambitious way, ideas for further theorising and new policy thinking can be drawn.

First, we offer a review of the problems of lending to the poor (section 2). This is followed by discussing the solution that group lending offers to these problems (section 3). Then we describe the Kiútprogram, how it has been devised and implemented (sections 4–6). The focus of our analysis is on how to escape from the poverty trap, as well as on the learning process during which the programme has evolved from following the standard group lending model to devising and introducing a new architecture. The main features of interactive learning while devising and implementing the Kiútprogram are highlighted in section 7. The concluding section summarises theoretical and policy implications.

## 2 WAYS TO OBTAIN CAPITAL BY THE POOR

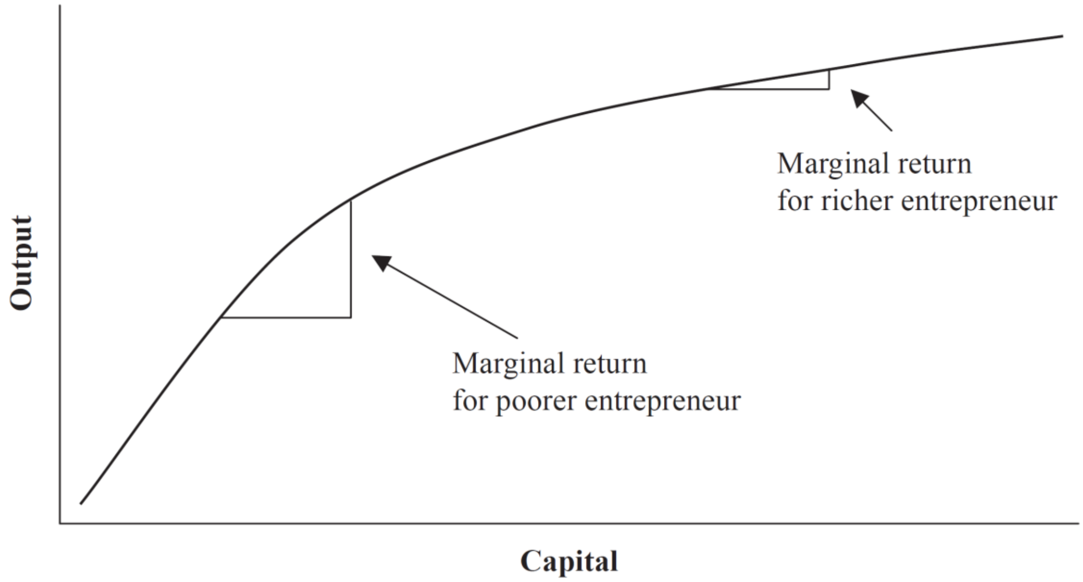
### 2.1 COMMERCIAL BANKS

In principle, standard commercial banks could provide loans for the poor to finance their enterprises, even charging a higher interest rate. Assuming a continuous, concave production function, the poorer entrepreneurs can reach higher marginal returns compared to the richer ones, and thus they could pay a relatively higher interest rate. This idea, presented in Figure 1, is recurring in studies and lectures advocating microlending.

[1] *Disclaimer:* On of the authors, György Molnár, was involved in devising the programme analysed in this paper, and he is still a voluntary member of the Kiútprogram Non-Profit Ltd. Board.

*Figure 1*

**Marginal returns to capital with a concave production function**




*Source*: Armendáriz and Morduch (2010: 6)

Poor borrowers, however, cannot offer collateral to the bank. Moreover, banks do not have information about them and collecting adequate information would increase the transaction costs to an unacceptably high level. When analysing this issue, economics literature identifies three types of problems: adverse selection, ex ante moral hazard and ex post moral hazard.[2] In practice, however, it is not a trivial task to distinguish them.

Regarding *adverse selection*, for the sake of simplicity, we distinguish two types of borrowers: safe and risky. At this level of abstraction, the exact reason for being risky is irrelevant: it can be the lack of competence of the borrower to run a viable business, his risk-taking behaviour, or the inherent riskiness of the chosen business. What is decisive, the bank does not know who is a safe and who is a risky borrower.

The total revenues of the investment made by the safe borrowers is a given quantity that exceeds the sum of the loan, the interest and the opportunity costs (e.g. social benefit lost due to the business activity). Risky borrowers, in turn, are either successful or unsuccessful with a given probability: in the first case they earn higher profit than safe borrowers do, in the second case they earn nothing. It has been shown that – even if the average return of the risky borrowers equals to the return of the safe ones – in the presence of risky borrowers the bank should raise the interest rates just to break even.

The higher interest rate is likely to drive out safe borrowers and hence only the risky ones remain in the market, further increasing the bank's risk. The information asymmetry would

[2] For further details of the issues discussed here see e.g. Armendáriz and Morduch (2010).

lead to an inefficient and inequitable solution. It is inequitable in the sense that the safe borrowers cross-finance the risky ones, unless they are completely pushed out of the market.

Ex ante moral hazard depicts the situation where the bank cannot know how much effort can be expected from the borrower. In simple models it is assumed that if the borrower makes all possible efforts, s/he makes a positive profit with certainty. In the other case s/he works only a little and earns a positive profit only with a low probability. Because of this risk, the bank would prefer to raise the interest rate, but it can be shown that above a given interest rate the borrower will no longer have an incentive to make efforts at all. This is clearly a trap for the poor.

Ex post moral hazard refers to the case when the project is successful, but the borrower decides not to pay back the loan. Although it is partly an ex ante phenomenon, we also include here the case when the borrowers spend the loan for other purposes, for example repaying their outstanding debts to a threatening local loan shark. Again, without any collateral the bank cannot enforce repayment.

For the above reasons, it is not a sensible behaviour for the *banks* to provide loans to people without the usual banking collateral. This is the situation even now, not only in the case of usual commercial banks, but also for most microenterprise development organisations.

## 2.2 INFORMAL MONEYLENDERS

The above obstacles do not prevent the local moneylenders from offering loans to the poor. The main difference between commercial banks and moneylenders is that the latter ones are familiar with the potential borrowers' personal traits and family circumstances, and thus the information asymmetry is smaller between the lender and the borrower. The lender knows well the income sources of the borrower, as well as when a certain income would be received (that is the basis e.g. for payday loans). A regular contact is maintained between them, demanding a significant effort from the lender. If the bank wanted to collect personal information on the potential borrowers in a similar way, its transaction costs would increase unacceptably high.

In the case of non-payment, the borrower loses the possibility of later borrowing, including contingent renewal. This can be especially detrimental if the loan is in the form of consumer credit at the local shopkeeper. Nevertheless, for objective reasons, the poorer the borrower is, the higher the probability of default. Moreover, poorer borrowers usually ask for smaller loans, but the monitoring costs by the lender are not proportional with the loan size. The interest rate is, therefore, relatively higher for poorer borrowers. This creates a vicious circle: when the interest rate goes up, the probability of non-repayment increases, consequently the borrower needs to be monitored more carefully, which raises further the costs of lending. (Banerjee and Duflo 2011) We can call this situation as a lending trap.

It is hardly possible for the borrower to switch to another lender: high initial investment into monitoring and screening by the moneylender severely restricts the competition between the lenders. Lack of competition not only weakens the bargaining position of the poor borrowers, it also leads to higher interest rates.

A special group of local moneylenders can be called loan sharks who apply violence, or credible threats of violence against defaulting borrowers. The possibility of violence may decrease the monitoring efforts by the lender, and so also the costs of the loan. The poorest borrowers, therefore, frequently turn to lenders who can violently handle them. Of course, these possibilities are not available for the commercial banks.

### 2.3 THE STATE

Governments have made several attempts to address these problems in various countries. They have launched credit programmes with subsidised interest rates or cost reimbursement measures targeting the poor in rural areas in India, Indonesia, the Philippines, and several other developing countries. In these programmes, however, lending has been frequently driven by political considerations (e.g. offered directly before the elections), the incidence of corruption has been very high, and – partly as a consequence of it – the costs have escalated to an unbearable high level. (Robinson 2001, Burgess and Pande 2005, Banerjee and Duflo 2011)

In Hungary, instead of providing preferential or unsecured loans, the government offers direct capital transfer to help unemployed people become entrepreneur, using EU financial sources.[3]

## 3 THE SOLUTION OFFERED BY GROUP LIABILITY

Microfinance, especially group lending, finds a middle way between the practices of the commercial banks and the local informal moneylenders. It is perceived by many analysts and international organisations as a tool to reduce transaction costs and information asymmetries. In the case of Yunus' Grameen Bank model, the distinctive feature of the lending activity is the creation of a voluntary, self-nominated group of five loan recipients, through which the collateral is replaced by mutual moral commitment.

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[3] http://www.pafi.hu/_pafi/palyazat.nsf/6dd21d90036cbc38c12575600042f0ec/7d3704dee6b9bc5fc125826b005bcd8b?OpenDocument

### 3.1 MAIN FEATURES OF THE GRAMEEN MODEL

During the planning phase and the first years of its operation (2010–2011) the Kiútprogram had tried to follow some of the most important features of the Grameen model. Thus, it is worth briefly recalling these attributes, drawing on Yunus (1999):

1) The essence of the Grameen model is providing unsecured loans of relatively small amounts to people living in poverty in order to create an opportunity to generate income. There is a pre-set upper income and property limit of being accepted in the programme, however there is now ethnical or religious selection.
2) The process starts when the fieldworker of the Grameen Bank arrives at the settlement and searches for people from the relevant social group who are interested in the project. The core of the credit providing activity is a voluntary, self-nominated group of five loan recipients, as the collateral required by banks are replaced by mutual social commitment of the group members. The group leader has a prominent role. She is usually the first of those actively interested. After she committed to the programme, the fieldworker often finds the other four group members by using her assistance.
3) In case of the first loan, credit can be used solely to finance income-generating activities, i.e. launching a business. The business idea comes from the credit recipients in every case and no preliminary training is deemed necessary before starting the business. Yunus considers this approach crucial: "From the very beginning, Grameen has gone against traditional methods of poverty alleviation by handling out cash without any attempt to first provide skills training. We have received a great deal of criticism for this policy, even from some of our friends. In Jobra we simply did not see any need for formal training, and our experience in the 1980s gave us more confidence that we had taken the right approach. (…) I firmly believe that all human beings have an innate skill. I call it the survival skill. The fact that the poor are alive is clear proof of their ability. They do not need us to teach them how to survive; they already know how to do this." (Yunus 1999: 140)
4) Loans are granted following a one-week course with the purpose of familiarising applicants with the process. There is a verbal exam to ensure that the applicant understands the process, the conditions, and takes responsibility for meeting the conditions. Another objective of this is to filter out applicants who are not willing to make a real effort (cf. the problem of ex ante moral hazard).
5) Initially two members of the group receive the loan. Weekly repayment starts already in the first week. If the first two loan recipients make the payments on time, loans will be granted to another two group members after six weeks, then the group leader gets the loan after another six weeks. If a member does not make a payment as approved in the

first 6 weeks, she is dropped from the group and the other members must find someone else as a replacement. Loans will not be issued until the dropout member is replaced. This feature is called sequential lending.

6) If the first loan is repaid as agreed, the loan recipient may be granted a new loan, which is larger in amount or can be used for a different purpose. However, if one of the group members have troubles in repaying and is not able to overcome difficulties, or does not want to make payments, then the other members of the group are given a penalty: even if they meet their goals, they will not be granted a follow-up loan.[4] This is a harsh measure as a new loan is often needed simply for continue the business, let alone when new investments are also needed. Group members, therefore, apply social pressure on each other to make sure that everyone pays back her first loan. Social pressure can take many different forms from excluding from mutual help to ostracising from the local community.

7) An important characteristic of the model is that a decisive majority of participants is women (95% in Bangladesh). Yunus explains this high ratio with the following main reasons: a) women have a higher level of commitment towards the family and the well-being of children; b) partly due to this, they are less inclined to spend money for other purposes; c) they are less mobile, less likely to escape from repayments; d) they can find less opportunity to earn money in alternative ways; e) finally, being suppressed by multiple forces, women display a higher desire to break out from their desperate situation.

Sequential lending and contingent renewal mean that the borrowers – even without direct mutual financial liability – act as guarantors for each other, and hence the usual banking collateral is replaced by *social collateral*. As Karlan et al. (2009) states: "[N]etwork connections between individuals can be used as social collateral to secure informal borrowing (...). The possibility of losing valuable friendships secures informal transactions in the same way that the possibility of losing physical collateral." (pp. 1307–1308)

## 3.2 HOW DOES GROUP LENDING WORK?

The *first crucial assumption* of the models investigating group lending is that the borrowers know each other's risk type and they can and are willing to effectively monitor each other. The denial of access to further credit can be an effective incentive to monitor the actions of their peers in the group.

[4] Chowdhury (2007) labels this feature as *contingent renewal*.

In the simple model of Stiglitz (1990) it is assumed that all individuals have two projects that they can undertake, a relatively safe, and a relatively risky one. There are two neighbours, who can monitor each other. The lender would like each to report if his neighbour is taking on the risky project, and thus creates incentives (e.g. denial of contingent renewal) to make them do so. The model shows that there are strong incentives for groups with similar risk characteristics to form, that is, homogeneous groups will be formed.

In a principal-agent model Varian (1990) gained similar results: based on an interview with only one group member, the lender can decide whether all of the group members are "safe" or "risky". One solution is that after the interview the bank does not issue loan to the members of the "risky" group.

Hence, peer monitoring can lead to the formation of segregated groups: the safe and the risky borrowers are not only identified, but will become members of different groups. This process is also referred to as "assortative matching". (Armendáriz and Morduch 2010) It should also be stressed that the higher probability of success does not depend only on the risk-taking behaviour of the entrepreneur. Appropriate knowledge, relevant practice and business connections are all needed for a business success. Assortative matching in group formation, therefore, can lead to the separation of the members of a poor community who possess these assets and those who do not.

Turning to the issue of moral hazard, the models addressing this question rely on crucial, but implicit assumption: *group members can efficiently impose social or economic sanctions on each other in order to enforce hard work and repayment*. Anyone who deviates is punished with social sanctions. In the most moderate case the social sanction is only the loss of valuable friendships, but it can take way more serious forms, when group lending creates peer pressure on the most vulnerable members of the community. For example, Montgomery (1996) mentions cases of enforced acquisition of household assets of defaulting group members. In many cases also non-economic coercion is used to ensure repayment (Ghosh 2013).

Considering the case of intentional non-repayment (strategic default), the other group members can successfully enforce repayment if the value of non-pecuniary costs for the defaulting borrower exceeds her gain from non-repayment. These non-pecuniary costs are wide-ranging. The majority of credit transactions which help smooth everyday income and consumption waves (or sometimes shocks) are conducted between relatives, friends and neighbours. These transactions are interest free and usually based on reciprocity (Platteau and Abraham 1984, Collins at al. 2009, for Hungary Gosztonyi 2017). Personal connections are extremely important for obtaining information on casual work possibilities, especially when a group of workers is needed (construction work, harvest, etc.). Information on cheap purchase opportunities, mutual help in childcare, or just talking as a form of entertainment and recreation, there are a lot of other situations where personal connections are very important in poor communities. In the absence of physical (and in a large extent cultural) capital, *social capital* is the most important “property” of the poor. (Bourdieu 1986) This *social capital works here as social collateral, to secure the loan*.

## 4 THE DESIGN AND LAUNCH OF THE KIÚTPROGRAM

The idea of adapting the Grameen model was taken up by the Polgár Foundation for Equal Opportunities in 2008, to serve its two central aims, that is, to decrease the level of prejudice and discrimination against the Roma and improve their living conditions in the most remote, deprived areas of Hungary.[5] In other words, microlending has always been understood as a device to achieve social aims – and not as a business activity to make profits.

As part of a thorough preparatory work, first a feasibility study was conducted by 25 experts – bankers, economists, anthropologists, social workers and teachers – who worked on it as volunteers for a year. Analysing the related literature, the Hungarian economic, social and regulatory conditions, as well as the experiences of an earlier, unsuccessful, Hungarian pilot project, the feasibility study identified several risk factors that necessitated a modification of the original model. These risk factors can be derived from the most important challenges faced by transition countries. Their manifestation in Hungary can be summarised as follows:

1) The existence and persistence of a ‘premature welfare state’ (Kornai 1992) is an important characteristic discerning the transition countries from developing countries and developed market economies. First, in comparison to developed countries, in transition countries social benefits for the unemployed are so low that they do not enable the reproduction of labour force at an adequate level. Moreover, the chances for the long-term unemployed to find employment are gradually decreasing. Second, unlike in developing countries, the willingness to take financial risks is significantly lower in transition economies, due to the still existing welfare system. This effect is especially strong: people who register for an entrepreneurial licence in Hungary immediately lose their right to receive welfare benefits.
2) The extension of public work schemes in 2009 and their massive expansion from 2012 (after a sudden decline in 2011; Cseres-Gergely and Molnár 2014, 2015) further decreased the risk-taking propensity of the unemployed.

[5] This section draws on Kiútprogram (2012).

3) Launching a new business requires more capital in transition economies than in developing countries. If a programme aims at creating employment in the form of self-employment, a larger loan should be provided than the usual amount granted in developing countries.
4) Entrepreneurs have to cope with highly bureaucratic structures: the bureaucracy in transition countries is by far more excessive than in developing countries. Bureaucratic obstacles for start-ups are extremely high in Hungary.[6] Outside of Budapest the situation is even worse.[7] For people with a low level of education and without being assisted in dealing with these issues, bureaucratic hurdles are almost impossible to overcome.
5) Throughout early childhood and the years in school, as well as when looking for employment, the Roma regularly face prejudices and discrimination. Long-term deprivation itself often leads to 'learned helplessness' (Peterson et al. 1993), as is well-known in psychology. This helplessness is further increased by experiences of being discriminated. The feeling 'no matter what I do, it will get worse in the end' becomes ingrained. To overcome this, most potential programme clients need a strong motivation. One of the most important tasks is to enable them to play an active role.
6) Taxation is inefficient in low-income brackets in the majority of the developing countries. This is less the case in Hungary; however, the presence of the informal economy is also prevalent. Income-generating microcredits often create businesses operating in the informal sector. However, the architects of the Kiútprogram were strongly convinced that operating in the informal sector does not represent a real solution to escape from deep poverty.[8] It may be suitable to improve living standards to some extent, but unsuitable for eliminating poverty. Working in the informal sector often even increases vulnerability and carries several risks. If social contributions are not paid, health risks become especially severe. Operations in the formal economy, however, carry an obligation to pay very high taxes and social contributions. In Hungary, there is no tax credit for people in the lowest income brackets[9] and self-employed persons have to pay taxes and social contributions as soon as they register as entrepreneurs.
7) The number of poor people is lower in Hungary than in developing countries and the number of potential clients in a settlement is relatively smaller. This has a distinct

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[6] The time required to launch a business in Hungary is four times higher than in the Slovak Republic and the gap is even wider compared to other neighbouring countries.
[7] However, in Budapest the time needed is less than the OECD or even the CEEC average (OECD, 2015: 56-58).
[8] This view is supported by international experience, see Bateman (2010).
[9] During the design phase that sort of tax credit was available for employees, but not for entrepreneurs. Then it was cancelled in 2011, when a flat-rate income tax was introduced in Hungary.

influence on the efficiency of operations. Furthermore, a different kind of microlending approach is suitable to facilitate the integration of the Roma, since their situation as an ethnic minority significantly differs from the situation of the poor belonging to the majority society.

8) In Hungary, the law regulating credit institutions and financial service providers does not include microcredits, while non-financial organisations are not permitted to grant loans as a business-like activity. However, the definition of business-like activity is not clear in the law. The Kiútprogram, therefore, has requested an official interpretation of the legislation from the Hungarian Financial Supervisory Authority, but it has failed to provide a relevant reply. Under these circumstances the Kiútprogram could not possibly lend money to its clients. A different solution was elaborated to circumvent this problem.[10]

Considering the above risk factors, the feasibility study specified those areas where it seemed useful to follow the Grameen model and those aspects where amendments deemed necessary. Four important deviations from the Grameen model were decided during the planning phase. First, fieldworkers were assigned a much bigger role than in the Grameen model, and they had to be continuously available for the clients. They should provide financial training to the clients, help in the complicated administrative processes and possibly counterbalance the discrimination against the poor and especially against the Roma at different offices. Second, the programme and the clients should operate strictly in the formal economy. As a consequence, the program covered a part of the social security contributions which had to be paid by the clients[11] and provided free book keeping services. Third, due to the high tax burden and the higher capital intensity, it seemed necessary to grant relatively larger loans (but below 3,000 euros) and allow for a longer than a one-year repayment period. Fourth, as a rather cumbersome, but necessary solution to the problem described above in point 9 of the list of the risk factors, loans were formally granted by a commercial bank (in the framework of its CSR activity) and as its agent a non-profit organisation administered the lending process. The decision of granting a loan was made by

[10] In consideration of the circumstances in Hungary this decision proved to be right. In 2014 a police investigation was started against the Ökotárs Alapítvány (Environmental Partnership Foundation). One reason for the investigation was that Ökotárs regularly provided bridging loans to other foundations without charging interest, thus enabling the implementation of these foundations' programmes by means of refinancing. (See http://4liberty.eu/newtheme/not-so-civil-hungary/ and a covering on the whole case by the Norway Grants at https://norvegcivilalap.hu/en/node/11226). Had the Kiútprogram granted loans by itself, its activity would have been a lot more business-like than that of Ökotárs.

[11] Hungarian entrepreneurs are burdened by complicated and cumbersome tax rules. From the very first month of operation, they have to pay taxes after the minimum wage. The assumption by the state is that an entrepreneur will make at least as much as the minimum wage.

the non-profit organisation; the commercial bank conducted the formally required background tasks, based on an appropriate contract. As to the legal form of the actual microcredit institution, a non-profit corporation was established that can utilise private capital; thus the Kiútprogram Non-Profit Ltd. was founded with the Polgár Foundation as its majority owner. In other respects, the founders of the Kiútprogram intended to follow the Grameen model.

We list those important features which were later partially or fully abandoned.

- Forming voluntary, self-nominated groups of five loan recipients, where the leader, as the most prestigious member, is elected by the others.
- Repayment starts already on the first week.
- Application of social collateral in the form of sequential lending and contingent renewal.
- The business idea always should come from the credit recipients and no preliminary professional training is needed before starting the business activity.

The funding of the programme was planned mainly from private and in a smaller extent from Hungarian governmental sources. Yet, just about when the feasibility study was completed and the recruitment of the fieldworkers started, an open call for proposals, entitled *Pilot project 'Pan-European Coordination of Roma Integration Methods' – Roma inclusion, Self-employment and microcredit* was announced by the EU. The Kiútprogram team applied and won the grant. Hence, between 2010 and 2012 this grant, together with the compulsory 10% Hungarian governmental contribution, was the main financial source of the programme.

# 5 THE FIRST PHASE OF THE KIÚTPROGRAM

## 5.1 EXPERIENCES AND THE FIRST MODEL CORRECTION

The recruitment of clients started much more slowly than expected as the programme encountered many difficulties. Certain problems arose from the lack of experience of the management and the fieldworkers, while others were structural. Here we highlight only the latter ones, that is, those that were related to the characteristics of group lending.

- *The rule that a group should consist of five people turned out to be too rigid.* As already mentioned, the ratio of poor people in Hungary is lower than in developing countries. Moreover, because of learned helplessness – or, using the other terminology, low aspiration level –, in many villages the number of potential clients was not enough to form a group of five as most poor people overestimated the risks of taking the loan and start a business. Consequently, the rules of group formation were eased.

- The Yunus principle of requesting repayment in one year also proved to be too rigid. However, the short duration and rules of the EU project implied keeping the repayment period at one year.
- It became clear that the assumption based on Yunus' views that the survival skills of the poor are sufficient to start a viable business does not hold in this context. During the implementation of the programme it became obvious that survival versus starting and running a business require entirely different skills. Some of the applicants had no realistic ideas what to do, others missed the necessary knowledge or business connections. *Professional and communication training of the clients, as part of the programme, proved to be crucial.*
- Even clients with clear and viable business ideas needed *additional help in network building*. One of the most important problems of local Roma communities is the lack of intercommunity connections, or the distrust of the non-Roma in the Roma: given that, they would not be willing to buy goods and services offered by the Roma. Consequently, the programme had to start network building activities, to connect clients with existing economic networks.
- In the case of seasonal activities (agriculture, forestry, trade) *sequential lending proved to be harmful*. The waiting period between two loan placements was reduced from six to four weeks.

These changes significantly improved the efficiency of the programme. In 2012, further changes were introduced, initiated by a group of clients who intended to join to an existing cucumber production system, operated by so-called production integrators. But, in their case not only the missing investment costs constituted a major obstacle, but also the lack of trust: there were no integrators who would have contracted with poor Roma. As the solution, the Kiútprogram entered into the contracts as a guarantor.

## 5.2 THE RESULTS OF THE FIRST PHASE

Between 2010 and 2012, during the EU-financed period of the programme, 153 loans were disbursed to 138 clients. The average loan size was 1,800 EUR, decreasing over time. The repayment ratio of clients contracted before the first model corrections was only 40%, while after the amendment it increased to 55% (without the cucumber subproject). In the cucumber production the repayment rate reached almost 80%. Operating costs (including lending losses) were high during the pilot period, the total cost of issuing EUR 1,800 was almost EUR 6,000. The largest share of costs was the fieldworkers' wages and other field expenditures. (World Bank 2013)

During the EU-financed period of the programme, a baseline survey was taken with the potential clients, and one year later a follow-up survey was conducted. 123 clients answered both questionnaires. We summarise here the most important results obtained from these surveys.[12]

Those clients are considered successful who have repaid the loan, had no arrears, or their arrears were less than 3 months at the time of the follow-up questionnaire. In this sense 56% of the borrowers proved to be successful. The income of successful clients' household increased by almost one-and-a-half times between the baseline and the follow-up surveys, while the income of unsuccessful clients decreased only by 10%, but this latter change is not significant statistically. Eighty percent of successful clients said that their participation in the programme improved their quality of life. Some of the typical explanations included becoming more optimistic, hopeful, gathered motivation and momentum for life, becoming more independent, confident, resolute, gaining a purpose in live, and a secure standard of living. Even more than half of the unsuccessful clients said that their lives had turned for the better, and only 12% of them reported a negative impact on their lives.

# 6 THE NEW FEATURES AND RESULTS OF THE KIÚTPROGRAM IN ITS SECOND PHASE

## 6.1 NEW FEATURES

After the pilot project, that is, when there was no EU funding available anymore, and thus national co-funding was not compulsory, either, the Hungarian government ceased this opportunity: it stopped supporting the programme altogether. The Kiútprogram, therefore, has solely been funded by donations received from private persons since 2013. That has meant a severe contraction of available financial resources, immediately leading to a significant cut in the programme's activities. Besides growing cucumbers by self-employed people, all other entrepreneurial activities had to be ceased from 2013. That helped reducing the costs per beneficiary, compared to those of setting up a new business.

Yet, this scheme has other constraints: it can only be offered to those clients who have access to a piece of land, where the quality of soil is appropriate. Moreover, this activity provides income only for five months a year. Another limiting factor is the weather. While the weather was overall favourable for cucumber growing in 2012, it became worse in the following two years, leading to lower volume of production. Naturally, that caused a lower loan repayment ratio. Moreover, given the climatic conditions of Hungary, *sequential lending in agriculture was impossible, and thus it was abandoned*.

[12] Further details are reported and discussed in Molnár (2017).

To further deteriorate the situation, several integrators cheated the clients in various ways, misusing their local monopolistic position. The biggest loss was caused when they sold necessary pesticides at extremely high prices, which were often 30% higher than the retail prices. This is also why many people sold their produce elsewhere. A different kind of dishonesty occurred when some of the buyers working for the integrators misled the clients by stating that the smallest and most expensive cucumbers are not accepted temporarily – but they are willing to buy them at the lower price paid for the bigger sized product. They instructed producers to mix the small cucumbers with the bigger ones, and paid the lower price for the mixed produce. Later on, they sorted the smaller cucumbers out, and collected the correct, higher price, thus cheating the clients. (interviews with the manager, fieldworkers and clients of the Kiútprogram, 2015–2016)

Learning these bitter lessons, the Kiútprogram in essence started playing the role of integrators, too, in 2015: it financed the current assets as well and entered into contracts directly with a food processing plant as a buyer.

The main features of the revised version of the Kiútprogram, introduced in 2015, can be highlighted as follows. This revised model offers:

- Interest-free loans for the investment costs (drilling a well, establishing a watering system with a pump, etc.) for two years. Clients are requested to repay 25% of the loan in the first year and the remaining 75% in the second year. The volume of the loan is primarily determined by the costs of drilling a well. The average volume of investment loans per client varied between EUR 310 and 560 in 2013–2016.
- Consumer loans, that is, all the necessary pesticides for the seedlings and production, calculated at regular market prices. It would have been easier – and also favourable, regarding the possible empowerment effects – for the Kiútprogram to offer loans to cover the costs of pesticides. As already mentioned, given the regulations, only registered financial institutions are allowed to offer loans in Hungary. Hence, the Kiútprogram would have breached these rules by offering loans directly to its clients. Yet, in this period, when the EU pilot project was over, no commercial bank was willing to deal with these clients. Hence, providing pesticides in their natural form was the only legal solution. The average volume of these loans (EUR 700 and 930 per client) exceeded the volume of investment loans (EUR 560 and 470) in 2015 and 2016, respectively. These loans are repaid by withholding the costs of pesticides from the price to be paid for the cucumber, but only up to 50% of the revenues due.
- A production consultant, who is available in the same village where the clients work.
- Direct trade contract with the final user (the food preserving plant).

This model significantly differs from the original model, in which the clients had the opportunity to become entrepreneurs. It has five advantages:

- It guarantees the possibility of joining an existing production network.
- While working, the clients can learn about production processes and acquire general agricultural knowledge in the most efficient way possible; for example, after two years clients who are often without a finished primary school education are able to follow the instructions on the pesticides' packages, and hence, for example, they can calculate the dilution ratio by themselves.
- Producers face a very low risk; the worst possible loss for them is working for a low crop yield. Even in that case they would still receive some income because registered agricultural producers, as opposed to entrepreneurs, are entitled to receive social benefits in case of need.
- Some decisions must be made in the course of the process (whether to plant early-season cucumbers or a late-season variety, how often to pick the cucumbers, how many metres to cultivate, etc.) but no genuine entrepreneurial spirit and skills are required.
- Unlike the frequently promoted self-sufficiency farming, within this programme people can earn money.

The loan repayment ratio improved significantly in 2016, due to the above changes in the major features of the scheme: while the arrears per payment due were fluctuating between 50 and 66% in 2013–2016, that level was 21% in 2016. An important contributor was the more appropriate training: the average yield of the Kiútprogram's clients reached that of other local cucumber producers by 2016.[13]

There are five non-negligible disadvantages as well:

- Cucumber growing is the only possibility what the Kiútprogram can currently offer; there is no option to start any other type of business.
- The programme can only be implemented where the soil is suitable for cucumber growing, and thus its diffusion is limited by natural constraints.
- Cucumber growing requires land: either the Roma need to have their own gardens or the the village should allow them to use available pieces of land.
- Income is rather volatile, it depends on the weather to a large extent.
- The programme can only secure work and income in the summer.

[13] Kiútprogram's annual report, 2016 and 2017.

*In brief, in this model the clients are in between employees and self-employed entrepreneurs.*

From a theoretical point of view, the most significant change was the *final abandonment of the contingent renewal condition*. Despite the efforts made by the fieldworkers and the peers, the share of strategic defaulters has stabilised between 10 and 15%. In their case the short-term advantage overwrote the medium and long-term harms from losing the trust of the others in their community. Bitter experience has shown that the basic assumption of the group lending model does not hold among the poor Roma in Hungary. In most cases the borrowers do not know each other's risk type. We illustrate this by means of an interview with a client of the Kiútprogram. This client is a role model for most people in the local Roma community. "I tell you that I trusted the people who tricked me most. We used to be good friends. They would not have done it to me. And as to the folks I did not trust, this is what I discussed with R. [the fieldworker], I knew they would cheat. Those were the first to repay the loan." (interview conducted by Molnár, June 2015)

The other crucial assumption, namely that the group members can efficiently impose social or economic sanctions on each other to enforce repayment was also not met. According to the Grameen model the peers of the defaulters would have lost the possibility of a business loan in the following year. In addition to being unjust, such a measure would have destroyed the credibility of the programme in the eyes of the Roma in the village. The Kiútprogram should have left the settlement, without any long-term positive impact in terms of alleviating poverty. Moreover, that could have developed distrust towards future initiatives aimed at reducing marginalisation and improving the quality of life of the poor.

## 6.2 IMPACTS AND RESULTS

### *Increased income of the clients*

One person can typically cultivate 300–400 running meters of plants and more, if several family members work during the harvest. Of course, the production area also depends on the available land.

In the first year of the production, the preparations take about four weeks, usually in April (digging the posts, stretching the wires, putting the watering system in place, etc.). From the second year on, preparing the soil takes only 2–3 days. Planting takes about 2–3 days in early May; afterwards only the water supply and the amount of nutrients added to the water have to be supervised. From then on, removing the tendrils and spraying pesticides, if needed, take 2–3 hours a day, on average. Picking the first produce takes about the same amount of time.

During the 2–3 months of the harvest, depending on the weather, one person has to work all day, 10–12 hours, and from time to time two people are needed full time if they want to produce and collect the smallest size of cucumbers (which can be sold at the highest price) on these 300 running meters.

The average production cost of one meter of cucumbers is 1.7 euros, investment cost not included. The potential gross income of experienced producers is 5–7 euros. Beginners and those who do not precisely adhere to the instructions may not be able to earn more than the double of the production costs.

As there is no systematic data collection, we will use the examples of two families, whereby one family achieved a lower than average income from cucumber growing and the other is the most efficient producer.

*The first family* cultivated cucumbers at 600 running meters. Because of a mismanaged pests problem[14] the family earned a net amount of 1,150 euros, and they were also repaying the remaining investment loan from the previous year. In the labour-intensive season the daily wage for 12 hours of seasonal work is about 10–12 euros (e.g. for picking apples, sour cherries, cucumbers on someone else's land). If the head of the household can go to seasonal work every day for two months, he or she can make about half of what they have earned by growing cucumber, but realistically the usually possible duration is only 2–3 weeks. In comparison, growing cucumbers is much more profitable.

How does this amount (1,150 euros) compare to the monthly income of the household? The first family consists of two adults and two children. Usually one of the adults is participating in public works. This family has no other income; and thus their income is 323 euros for the four persons, including the tax credit for the children and the family allowance. The older child is very smart and attends a secondary school. Despite the fact that the family is poor, the state covers only a part of the dormitory fees; in total, the cost of accommodation, food, supplies, and transport amounts to approximately 92 euros. Consequently, the remaining three members of the family have to live on 231 euros per month, i.e. 2.5 euros per person per day. Compared to this, 1,150 euros is a significant amount, which is mostly used to buy firewood, repay the debt at the grocery shop, and buy school supplies and clothes for the children at the beginning of the school year. Without

[14] Although it is not an income problem, it offers valuable lessons as to how this could happen. These clients have grown cucumbers for the second year. When the pests appeared, the damage was similar to an earlier incident; therefore, they thought that they knew what pesticide to use and they still had some of this pesticide left. Out of pride and thinking that they could handle the situation, they did not report the problem to the expert of the Kiútprogram. They only reported it when the pesticide was not working (since it was a different kind of pests).

participating in the cucumber project it would have been impossible for this family to finance the secondary school education of their older child.

The income of the abovementioned family (not counting the income from cucumber production) is about average in the region. The living conditions of families with more children and less public work are even worse.

The net income of *the second family*, the best producer, was 4,670 euros; to achieve this income two adult family members worked almost day and night. This family has a somewhat higher monthly income; they are on good terms with the mayor and often both parents are employed in public works. In comparison to the first family, this provides an additional monthly income of 170 euro. The family has three children and lives with the wife's parents in a very small house but they would like to live independently. They work with extraordinary ambition and attention, which results in an excellent yield. Almost one third of the income coming from the cucumber growing in 2014 was spent on firewood and food, while the rest of the income was used to pay for half of the price of a house in the village. Next year they paid the remaining half from the income achieved through cucumber growing.

*Further impacts on the clients*

The most important impact of the programme is that the participants learn about agricultural production. Although the majority of the clients often work as seasonal workers during the harvest, they do not fully understand the whole production process.

Typically, two things are especially difficult to understand for the beginners. First, they have to understand that an excessive use of fertilisers is harmful. This is difficult because initially using too much fertiliser seems to enhance the plants' growth. Second, they have to understand and learn the technique of removing the tendrils: the yield will be better if some of the new sprouts are removed. In this way the clients of the programme gain a more general agricultural knowledge, which not only applies to cucumber growing.

The Kiútprogram clearly proved that learning integrated into practical work is more efficient than learning plant growing by means of a theory-focused, school-like education programme. As already mentioned, Kiútprogram's clients reached the average yield of the other local cucumber producers by 2016, thanks to the applied training methods.

*Impacts on the social environment*

The respect towards our successful clients, that is, who repaid the loans, clearly increased in their village.[15] One sign of this is that they are granted interest-free credit in the village shop because the shop owner thinks they do not pose a risk. It is worth quoting from an interview with a fieldworker on this topic:

> "Good clients are more respected; they like going to the village [from the 'Tzigane streets' on the outskirts of the village] and when they do so, people listen to what they say and they are confident to go to the shop. They are not discriminated against in the local pub and if they go there, the others talk to them. Bad clients, however, fall in the local hierarchy and have a lower position than before (...). There are some people in the village I haven't talked to yet and I hear their opinions haven't changed a bit. They think the Tzigane are what they used to be and say derogative things. But people we have closer connections with, those who meet their neighbours or see them work very hard or live within a 1-km radius, close to our clients; they are different. In some situations, we helped them too [i.e. non-Roma neighbours by lending tools, giving advice]. Sometimes they come over and see that we are in the garden all the time and they appreciate our help. They said that they would help the people we support and they would help us too." (interview conducted by Molnár, June 2015)

Clearly, one should not draw conclusions from one incident, but the following statement illustrating the effects of a Roma family buying a house in the village is noteworthy:

> "Our clients are very happy; they see that this is as a triumph, an achievement. And they help B. to move house and visit the family often. The new house is not complete yet, but they spend a lot of time in the yard, they meet, cook outside, etc. The non-Roma have a mixed opinion, some are happy, some are not. Altogether, I believe that more people are supportive. They see how far B. has come and what he achieved by himself, with our help. To good people, decent people, this is always positive... [About the future neighbours:] They were happy. They know the family, they know that the lot will be kept in order, so they are all right." (interview conducted by Molnár, June 2015)

In this village, where the Kiútprogram has the highest number of clients, the candidate who was later elected mayor, visited the parts of the village where Roma people live for the first time during an election campaign. This has not happened at other locations yet.

## 6.3 THE DIFFUSION OF THE KIÚTPROGRAM

The model of the Kiútprogram had no followers so far. As long as the state does not co-operate with such programmes in Hungary at all, it is unrealistic to expect any followers. This is not primarily about financial support, but about the legal and regulation framework, paying of contributions, and the decision-making mechanism in programmes financed by EU funds.

However, it makes sense to discuss the geographical diffusion of the programme. As has already been mentioned, the first steps of the fieldworker in a settlement are always very

[15] It is important to stress that the Kiútprogram does not reveal any information about repayment, but the information is spread among the clients by themselves very quickly.

difficult. News about the Kiútprogram reached more and more people in the area. This effect was visible already in the second year of the first phase of the programme, but it was not possible to benefit from it. It was certainly useful, however, when setting up and running the cucumber project.

*Diffusion within a settlement: the role of the clients*

The first and simplest phase of diffusion is *within a given settlement*. The *first* clients belong to two rather different groups:

- Very committed and strongly motivated people who try to take any opportunity to improve their situation and have some kind of entrepreneurial dream (this was important in the first phase) or some agricultural experience (for cucumber growing).
- People attracted by the loan; they believe that it is an easily obtainable revenue and they do not intend to pay it back.

It is an important task for the fieldworkers to differentiate between the two types, which is not easy. It is worth looking at this issue somewhat closer, although it is only indirectly related to diffusion. As to the second type of first clients, a fieldworker said: "Those who sell the cucumbers somewhere else will take the revenues, it does not matter what we do. They decide in the first moment that they will trick us anyway, which is very difficult to identify; if they do not decide it early on, they will try to create conflicts to make it happen." (interview conducted by Molnár, June 2015)

As already discussed, the original Grameen model uses group lending and peer pressure to avoid this. This, however, did not work in the Hungarian context. In the first phase of the Kiútprogram, group formation was helpful in the selection of clients, but the gradual loan issuing and peer pressure did not work. During the implementation of the programme the leaders learnt that *using peer pressure is not right either from a theoretical or a practical point of view*. The theoretical problem is that beyond a certain level of peer pressure there is no difference between peer pressure and coercion. Of course, the level of pressure applied cannot be controlled by the lender.

*If we want to avoid psychological coercion, the selection of clients can only be the result of a carefully built process, which might take several years, and thus implies additional costs.*

Returning to the question of the diffusion of information about the programme within a settlement, in the first year most people just wait. They observe the first entrepreneurs' results with interest. Some of them do not trust the programme; they fear that it is cheating: in the end they will have to repay much more money. The local mayor and clerks may have a key role in establishing trust. Further, there are people who have never done similar work, and thus are afraid of the unknown and of failure. Others fear that they will not earn enough money, loose public works, or miss other seasonal work opportunities. Understandably, people in the worst situation have the lowest self-confidence and the biggest fear of failure.

One new client, who joined because he worked with cucumbers as a day labourer in the neighbouring village, said about the abovementioned 'observers', that is, those who wait and see: "If we succeed, they will take heart; now, they are still afraid. At the beginning they did not want to participate in the programme but now that they see that the cucumber is growing they regret that they did not join. Now they are sorry and many of them ask me to give them P.'s phone number because they want to join next year. They come and examine the dripping system and ask me how to start. In my street at least 15 people would have started it after seeing what happened." (interview conducted by Molnár, June 2015)

There is a problem for the Kiútprogram in this situation. If the programme aims at financial security too much, people who are in the worst situation may not be included in the programme. On the other hand, if too big financial risks are taken, in case of failure no one can be helped at that location any more. The team of the Kiútprogram is aware of this dilemma but it is not easy to establish a dynamic balance. *This also demonstrates that an important prerequisite of successful social innovation for marginalised people is a high risk tolerance of innovators and sponsors.*

*Diffusion between settlements*

Information spreads in two ways between settlements: through relatives, acquaintances, or the media. On several occasions potential clients contacted the fieldworker based on information they received from existing clients from other villages.

Another typical way is that the mayor or other local leader contacts the Kiútprogram because they heard about it in the media. This is how the programme reached a neighbouring county from its current central area.[16] It is clear that there are many advantages if the local leadership is supportive; however, there are risks too. If the programme gives supportive locations too much preference, it lets down those who need help most because of the hostile local leadership.

## 7 INTERACTIVE LEARNING WHILE IMPLEMENTING THE KIÚTPROGRAM

The broad understanding of business innovation entails that not only codified scientific and technical knowledge [= information], stemming from R&D projects, but practical knowledge, including its tacit elements, are all needed. Further, given the dynamic nature of innovation

[16] From Szabolcs-Szatmár-Bereg county to Bodrogköz, which is part of Borsod-Abaúj-Zemplén county.

processes, besides already available knowledge, learning capabilities are also of major importance.

The interactive model of learning and innovation (Caraça et al. 2009) reflects these features in a fruitful way, and thus offers guidance for a thorough and reliable analysis of actual cases.[17] In other words, this model does not aspire to characterise 'the' innovation process, including its "stages" and causal links. Rather, it is a focusing device that highlights (i) the types of actors who can be involved in actual innovation processes, playing their own, diverse roles; (ii) the types and forms of knowledge, which are needed for successful innovations; (iii) the importance of interactions and exchanges among the actors, including the flow of information, knowledge, and capital; (iv) the role played by the formal and informal rules that govern these interactions and flows, and thus the key role of the actors who set and shape these rules; as well as (v) the other elements of the macro environment, including the education system, the information infrastructure, and the availability of private and public funds for innovation.

The Kiútprogram can be adequately characterised using this focusing device. Its major actors include: private funders and *leaders* of the program, with a variety of business knowledge and experience; advisors, with social science analytical skills; *fieldworkers*, with capability and social capital building experience; the *clients*, usually with low level of educational attainment, no experience in agricultural production, in many cases impeded by learned helplessness and severe mistrust in the institutions (understood here as 'rules of the game') set by, and organisations run by, the local and central state, as well as the members of the 'majority' society; the potential clients; the political leaders of a given village, where the program operates. These actors have learnt a lot while the Kiútprogram has been implemented, both by relying on external knowledge sources and – to a significant extent – from each other. A thorough description and analysis of these learning processes would require a separate study, and thus only some important elements are highlighted below.

When setting up the program, the *leaders* broadened their knowledge base by commissioning external experts to analyse: the Grameen model; foreign and other Hungarian attempts to fight poverty; marginalisation dynamics and exclusion processes – both their generation and reproduction – with a special attention to the Roma minority in Hungary. During the implementation, learning by doing has also been decisive. As described in detail earlier, major changes have been introduced: the practice of social collateral was abandoned; fieldworkers were given an even more important role and responsibilities than

[17] For a review of other models of innovation developed to analyse business innovations – the science-push, the market-pull, as well as the so-called chain-linked ones – see Havas (2016), where the focus is on the (ir)relevance of these models to study social innovations.

originally envisaged for instance in building intercommunity bridges and reducing prejudice when dealing with administrative matters in various offices; trainings – mainly in the form of on-the-job, practical training – proved to be more important than thought of during the planning phase. The founders have also better understood that a loan plays a double role: besides its ‘normal’ role to facilitate business activities, it is crucial in fighting learned helplessness. Further, they have learnt about the behaviour of clients, their immediate environment, the norms and culture in those micro societies, and thus the importance of building trust. Without an adequate level of trust, it is simply not possible to help marginalised people in a ‘sustainable’ way. From a different angle, the leaders of the programme have learnt a great deal from external sources of knowledge, from the fieldworkers, from the clients, as well as from each other.

The *fieldworkers* have also learnt a lot about the behaviour of clients, their immediate environment, the norms and culture in those micro societies, and thus the importance of building trust partly directly from the clients, and partly from each other. They have also learnt from the leaders of the programme, in particular about the relevant foreign models and methods to fight marginalisation, the Hungarian regulations, as well as the behaviour of market actors. Further, fieldworkers have noticed that the high ambition of clients is likely to backfire – e.g. they applied too much pesticides to increase yield – and thus together with the external agricultural experts they amended the content of the on-the-job training.

The *clients* have learnt from the fieldworkers and other experts, who have provided business and technological advice for growing cucumbers, devising a basic business plan, obtaining the necessary permissions, dealing with desk officers in various offices, including branch offices of banks. They have also learnt both from the fieldworkers and the leaders of the programme that it is crucial to meet the obligations set in contracts and that the members of the ‘majority’ society can be trusted.

The Kiútprogram has shown that as in business innovation processes, many different types and pieces of knowledge flow between the actors, including codified knowledge in the form of scientific knowledge, as well as tacit knowledge accumulated through own practice. In other words, both S&T and practical knowledge is crucial for a social innovation. The ‘subject matters’ are also wide ranging, spanning from agricultural production methods through knowledge on financial and market issues to understanding the formal and informal rules, as well as the norms of special micro societies. The actors also learn a lot from each other, as well as from their own experience, while performing their role in implementing the programme – this is learning by doing and interacting in its ‘classic’ sense.

To sum up, as in the case of most innovation processes, implementation has been a *trial and error* process: accumulated experience has been analysed continuously and internal rules and methods modified accordingly. Client feedback has been systematically collected and considered. The programme also had to be modified due to changes in external circumstances, especially the regulatory environment. It had to be managed in a flexible way; managers had to constantly learn. Support schemes, however, are usually rather rigid given the strict rules introduced to prevent misuse of public funds; in quite a few cases it is fairly hard to amend a social innovation project, even when necessitated by internal learning and/or changes in the external environment.

## 8 CONCLUSIONS

During the almost ten-year long learning process, from the simple adaptation of the Grameen model, the Kiútprogram has arrived to the denial of the most important features of joint liability in group lending, namely the application of the devices of social collateral. It has also become clear that a loan itself is not sufficient to assist in escaping from the poverty trap. Without knowledge transfer and without inter-community connection building – at least in the case of discriminated minorities – the effect of the loan may even be detrimental. In a modern society not only physical, but also social and cultural capital is needed to run a successful business in the formal sector of the economy.

The Kiútprogram helps in generating cultural and social capital through the activities of highly skilled, experienced fieldworkers who are always available as they live nearby. Their wages cannot be charged to the clients: that would be against the basic objective of alleviating poverty. Hence, these programmes cannot possibly be financially sustainable. Continuous external funding is a prerequisite, which can be provided by the state and private donors. Policy-makers should compare the costs of supporting this type of social innovations with those of supporting long-term unemployed, low skilled people, also considering that self-employed people pay taxes and social contributions. At a macro level the balance is likely to be positive, that is, contributing to the costs of these social innovations is likely to be a smaller burden on the budget than disbursing social welfare.

As in the more general case of aid to developing countries, the real question is not whether microlending is useful or harmful. The effect depends on the way, in which the loan is provided, as well as on the kind of other services and assistance offered with it. As for training to the clients, it is worth comparing Yunus' position with the experience of the Kiútprogram. "Government decision-makers, many NGOs, and international consultants usually start the work of poverty alleviation by launching very elaborate training programs. They do this because they begin with the assumption that people are poor because they lack skills. Training also perpetuates their own interests – by creating more jobs for themselves without the responsibility of having to produce any concrete results. Thanks to the flow of aid and welfare budgets, a huge industry has evolved worldwide for the sole purpose of providing such training." (Yunus 1999: 141)

Yunus is correct regarding a strong mistrust in formal education based on bad experience with the school system. The large majority of Kiútprogram's clients, however, had never been involved in any agricultural activity prior to growing cucumber, assisted by the programme, and thus they had to be trained. When planning this type of training, the characteristics of adult learning must be considered. The most efficient and lasting learning method is going back to existing empirical knowledge and building further knowledge on this foundation. Clients gain the most lasting and useful knowledge through learning embedded within practical activities, that is, being trained while performing their tasks.

Nevertheless, the role of the loan is not only providing financial sources for the initial investment. In the Kiútprogram's model it *plays a crucial role in escaping from the aspiration trap, and thus helps overcome learned helplessness*. Loans provided without any – financial or social – collateral signal that the lender trusts the client, not only in her honesty, but also in her abilities. This method of lending strongly suggests to the clients the conviction that she is able of achieving a business success. *Neither financial aid on its own, nor loan with (social) collateral is suitable to reach this effect*.

Recalling the four intervention (policy) categories of Dalton and Ghosal (2011), mentioned in the introduction, we can categorise group lending with social collateral as indirect paternalism. Clients are governed towards a situation considered desirable by the actor, with strong incentives. The practice of Kiútprogram raises the possibility of a fifth type of intervention against the aspiration trap: providing genuine possibilities (in this case in the form of loan, and cultural and social capital transfer) and *trust* at the same time. This solution satisfies also the claim of Flechtner (2017) to avoid frustration. Using Sen's terminology, we can call this kind of intervention as the *capabilitarian approach* (Sen 1999). It provides genuine opportunities and strengthens the capacities to aspire.

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