Berichte

Finance at the Frontier*

A Review Article

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I. The Background

Only about ten years ago, a small group of specialists at the World Bank and at Ohio State University turned development finance from a dull administrative routine into an exciting field for academic research and professional excellence. The trailblazing insight of *J. D. von Pischke, Dale Adams* and their associates was that development finance should be much more concerned with developing financial markets and institutions than with channelling subsidized funds from donors in industrial countries to beneficiaries in developing countries. The people belonging to this group were able to pinpoint the "abuse of ... financial markets in developing countries" by the prevailing approach of donors and LDC governments, and to show how external financing through conventional development banks was in fact "undermining ... development (in particular the development of local financial systems) with cheap credit".[1]

* *J. D. von Pischke:* Finance at the Frontier. Debt Capacity and the Role of Credit in the Private Economy. EDI Development Studies, Economic Development Institute of the World Bank, Washington, D.C.: The World Bank 1991, XII + 427 pages, bibliographical references and index, ISBN 8213-1818-7, US-$ 22.95 (DM 50,50).

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[1] The quotations are taken from the titles of the two most influential books on the new thinking about financial markets in developing countries. These are: *J. D. von Pischke; Dale W. Adams; Gordon Donald* (eds.): Rural Financial Markets in Developing Countries: Their Use and Abuse, Baltimore/London: The Johns Hopkins University Press 1983, and *Dale W. Adams; Douglas H. Graham; J. D. von Pischke* (eds.): Undermining Rural Development with Cheap Credit, Boulder, Col.: Westview Press 1984.

The critique was forceful and intellectually convincing. It also had some practical impact, but it did not succeed in causing a complete revision of donor policies. This resilience can be explained in part by the general slowness of political and administrative processes. Another part of the explanation is probably that, at a time of prevailing financial repression, von *Pischke, Adams* and their friends could not be too specific in describing a more sensible market-oriented approach to development finance. An important third reason was pointed out in one of the most stimulating early papers by *J. D. von Pischke* and his associates, in which they identified and described the role of the vested interests of all parties involved in a process which is rightly characterized as distributing patronage under the guise of aid.[2]

II. The Basic Messages

J. D. von Pischke's new book "Finance at the Frontier" is the first comprehensive treatise on development finance for small farmers, small businesses and other ordinary people written by one of the authors who initiated the new thinking and who has since then tried to put his ideas into practice. Quite naturally, this new book attracts the greatest interest on the part of all those practitioners and academics who were influenced by his earlier work. Have his ideas evolved during a decade in which ideologies and policies in the industrialized countries of the West have changed as much as the economic situation of most LDCs? This, of course, raises the two questions whether the old critique is still valid and continues to form the basis of his analysis and whether it has been possible to make the constructive elements of his concept more operational. The answer to both questions is clearly "yes".

"Finance at the Frontier" is a great book: it is thoughtful and thought-provoking, critical and constructive, lucid in content and brilliant in style. And it will certainly have a strong and lasting influence on conceptual thinking and professional practice. It is exactly the kind of book which his many admirers have expected from *J. D. von Pischke!*

What is "the frontier"? *Von Pischke* defines it "as the limit of the activities of formal financial institutions" (p. 317). "Finance at the Frontier" is about the problems and prospects of pushing the frontier outward. The main message of the book is that this should be attempted, and can be achieved. It is

[2] *J. D. von Pischke; Peter Hefferman; Dale W. Adams:* The Political Economy of Specialized Farm Credit Institutions, Staff Working Paper No. 446, Washington, D.C.: The World Bank.

possible "to make good loans to individuals and firms at the frontier" (p. VII). Financial institutions can lend to people who are not conventionally regarded as creditworthy – people, in other words, who do not seem to have debt capacity. It is "the function of financial markets to develop and exploit debt capacity, (and) debt capacity created is a proxy for development" (p. 316).

Von Pischke builds his book on the premise that "financial markets create value" (p. 5). But at the same time they create risk. The counterweight to risk, and thus an indispensable prerequisite for the creation of value, is confidence. Confidence is more than "emotion and perception" (p. 42); it is a state of expectations which is well grounded in facts and experience. The ability to manage and assume risk creates confidence. A decline in confidence destroys value.

In order to create value, financial institutions must lend with an extreme awareness of the risks which credit entails for borrowers and lenders. As the author emphasizes and elaborates in the book, current lending policies are not risk-conscious enough and thus fail to achieve their objective. And risk-aware lending at the frontier can only be expected from financial institutions which are stable and viable. This requirement is also not satisfied by most lending institutions currently operating at the frontier in developing countries.

With the all-important proviso that risk be taken into account properly and that lending institutions be sustainable, *von Pischke*'s second main message to the community of development aid professionals is that "lending at the frontier can be remunerative to commercial banks, development banks and other development finance agencies who retail credit and assume credit risk". This message is encouraging and simple. But, of course, it does not imply that lending at the frontier is simple. It is in fact quite difficult. *Von Pischke* is an advocate of simplicity, but in a very specific context and with respect to very specific aspects of his approach. As he argues convincingly, successful credit programs must have a simple design and pursue simple lending strategies. One of the reasons for the failure of many past and present projects is that they were not simple enough; they tried to accomplish too many different things simultaneously.

III. Finance: Value, Risk, and Confidence

"Finance at the Frontier" contains 14 chapters and is divided into four parts. Part I defines the basic concepts of value, risk and confidence, shows how they are interrelated, and develops the book's main propositions. It is very helpful for the reader that the author explains and illustrates his concepts so carefully, as they are indeed not always used in accordance with standard economic theory. But this is all the better in view of the serious problems which economic theory has with the twin concepts of finance and development. However, *von Pischke*'s concept of value is less unorthodox than he seems to think (p. 4) as it is in fact quite close to the concept used in the Austrian tradition of value theory. The concept of confidence remains undefined, but it is so well illustrated that the lack of a proper definition does not cause any problems.

The best chapter in part I, and perhaps even in the entire book, is chapter 3, which deals with "the characteristics of finance". It contains the essence of the book. It is very easy to read and presents an abundance of insights. The chapter begins with an important statement: "The market for finance is basically different from the market for soap or cement" (p. 67) and a reference to the famous *Stiglitz* and *Weiss* paper on credit rationing.[3] To a much greater degree than in the markets for conventional goods and services, the performance of financial markets depends on the distribution of information and the accuracy and stability of expectations. Incentive problems are endemic to financial markets. That is the "theoretical" reason why confidence and long-term relationships between borrowers and lenders are so important: they help to overcome the information and incentive problems which would keep financial markets from functioning properly if all transactions were conducted by faceless agents. In pointing out the necessity of confidence and enduring financial relationships – and, indeed, by building his entire approach on these ideas – *von Pischke* has, more or less in passing, made a great contribution to bridging the gap between the modern theory of financial markets under imperfect information (*Stiglitz*) and development finance.[4] We shall return to this point below.

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[3] *Joseph E. Stiglitz; Andrew Weiss:* Credit Rationing in Markets with Imperfect Information, in: American Economic Review, Vol. 71 (1981), pp. 393 - 410. Another and more extensive reference to *Stiglitz* and *Weiss* is on page 215 of the book.

[4] *Stiglitz* himself and others who work in close collaboration with him have written extensively on information economics and development finance, see e.g. *Joseph E. Stiglitz:* The New Development Economics, in: World Development, Vol. 14 (1986), pp. 257 - 265; *Joseph E. Stiglitz:* Markets, Market Failures, and Development, in: American Economic Review, Papers and Proceedings, Vol. 79 (1989), pp. 197 - 203; *Avishay Braverman; Luis Guasch:* Rural Credit Markets and Institutions in Developing Countries: Lessons for Policy Analysis from Practice and Modern Theory, in: World Development, Vol. 14 (1986), pp. 1253 - 1267, and *Avishay Braverman; Luis Guasch:* Rural Credit Reforms in LDCs: Issues and Evidence, in: Journal of Economic Development, Vol. 14 (1989), pp. 7 - 33.

IV. An Update of the Old Critique

Part II is a summary and update of the devastating critique from the early 80s. The author does not take back what he and his friends have written. The verdict in chapter 4 on "credit needs" and other "bankrupt approaches" which still dominate development aid practice is as outspoken and uncompromising as ever. "Common strategic flaws in efforts to channel credit to the frontier" (chapter 5), "policy and practice that reduce value at the frontier" (chapter 6) and "signs of poor fit at the frontier" (chapter 7) are analyzed and criticized with admirable clarity. They are identified as one important reason why the billions of dollars which have, over the years, flowed into target-group-oriented lending in the developing countries (p. 65) have failed to move the frontier outward.

In tone and substance the critique is clearly in the tradition of the earlier work of *von Pischke, Adams* and their associates.[5] It is important and, indeed, gratifying to see that the critique has not been taken back or watered down because there is nothing to take back! With one exception which will be discussed below, concepts, policies and practices of development aid bureaucrats have not changed very much during the last decade. To most "experts" in the bureaucracies, it is still a mystery why the notion of "credit need" is discredited, as they keep sending out other experts as consultants who roam the developing countries in search of "credit needs". And almost invariably these consultants come back with estimates of "credit needs" which are much larger than the volume of credit which individuals and firms would demand if credit were priced in accordance with cost and risk, and greatly in excess of what risk-aware lenders could reasonably lend out at the frontier. As they were a decade ago, credit programs are burdened with irrelevant requirements pertaining to the questions of who borrows and for what purposes. And the problems of intermediaries are treated as negligently as ever.

The old gospel has not been heard or understood well enough! Therefore, it is good that it is repeated – in a language which does not intimidate practitioners, and in a book which is easily accessible.

In spite of all the apparent continuity in this part of the book, there are some interesting elements of change. Some are just changes of emphasis, some are changes in substance, and some are both.

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[5] See also the synthesis in *Dale W. Adams; Douglas H. Graham:* A Critique of Traditional Agricultural Credit Projects and Policies, in: Journal of Development Economics, Vol. 8 (1984), pp. 347 - 366.

One example of an old topic with a new emphasis is the lack of hard empirical data relating to the performance of institutions which retail credit at the frontier (pp. 128 and 164). This lack is indeed evident and annoying. It only shows that institutional development is not a genuine concern of most donor agencies. Another example is *von Pischke*'s skepticism vis-à-vis credit as a tool of development policy: "However helpful it may be, credit is not an essential component of development" (p. 70), and it is often not helpful at all. And in many cases, other instruments are more appropriate than credit to address specific development problems (e.g. p. 282).

More change than continuity is reflected in a statement on p. 110: "Experience with credit and development finance projects suggests that institutional development is stubbornly difficult, especially when incentives are not carefully analyzed". This is clearly a lesson of the last decade. Ten years ago it seemed that liberalizing interest rates and giving some limited start-up support to institutions would suffice to make them operate successfully at the frontier. The new skepticism is justified. It does not invalidate the fundamental critique, nor does it imply that institutional development should not be attempted. It only makes the critique appear more fair and thus also harder to refute. And it is, of course, the main motive underlying the new and constructive parts of the treatise.

There is one section of chapter 6 which exhibits too much continuity and reflects too little change. On pages 118 - 126, *von Pischke* reiterates the critique of "artificially low interest rates" as a characteristic of ill-designed credit schemes. This issue is not as straightforward today as it was a decade ago. Around 1980, "financial repression" was still prevailing in most countries of the world. This gave a simple and clear meaning to the term "artificially low interest rates": "Artificially low" meant "negative in real terms". Only by way of implication did it also mean "below economic cost". The meaning and the object of the old critique were easy to identify. The intellectual underpinning of the critique appeared to be equally beyond doubt. In fact, there were two strands of reasoning behind the attack on excessively low interest rates. One was a political-economy argument spelled out most forcefully by *Edward Kane*.[6] The other argument was taken from standard welfare theory applied to financial markets. The classical source is *Claudio Gonzalez-Vega*'s article on "the iron law of interest rate restrictions".[7]

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[6] *Edward J. Kane:* Political Economy of Subsidizing Agricultural Credit in Developing Countries, in: *Dale W. Adams, Douglas H. Graham* and *J. D. von Pischke* (eds.): Undermining Rural Development with Cheap Credit, Boulder, Col.: Westview Press 1984, pp. 166 - 182.

[7] *Claudio Gonzalez-Vega:* Credit-Rationing Behavior of Agricultural Lenders: The Iron Law of Interest Rate Restrictions, in: *Dale W. Adams, Douglas H. Graham* and *J.*

But reality and theory have changed. The last decade brought a wave of liberalization and stabilization to many parts of the world and as a consequence real interest rates have soared in several countries. There are now legitimate concerns that interest rates may be too high instead of too low. This change in reality is not reflected adequately in *von Pischke*'s treatment of the issue. The same applies to changes in economic theory which are relevant here. *Gonzalez-Vega*'s analysis treats financial markets as if they were just like the markets for "soap and cement" (p. 67). It implies that financial markets without interest rate restrictions would lead to equilibrium interest rates with the desirable standard welfare properties. But due to the work of *Stiglitz* and his collaborators on information, incentives and credit rationing, which is rightly acknowledged by *von Pischke* and in fact fundamental to the main thrust of his book, it has now become the accepted view that the equilibrium in "free" financial markets may simply not exist, or may not be unique and is most likely to have undesirable welfare properties. The notion of "artificially low interest rates" has become obscure, and the welfare-analysis of the *Gonzalez-Vega* article is simply not valid any more. Even among the intellectuals at the World Bank, interest rate restrictions and interest subsidies are now no longer regarded as unthinkable.

Von Pischke avoids this controversy. But he seems to be aware of it because in his exposition he only relies on the political-economy arguments and does not even quote *Gonzalez-Vega* in this part of the book. It appears that the critique which is presented is still valid after financial repression ended in a large part of the developing world and after information economics started to become a pervasive force in thinking on finance and development. But how wrong are those who flirt with the idea of restricting the interest rates which financial intermediaries are permitted to charge "poor borrowers"? And conversely, how high must interest rates be to avoid the charge of being "artificially low"? What is the standard for determining appropriate interest rates? Should they be set according to prevailing market rates or based on total costs, and what should be done if cost- and market-based rates differ considerably? And are some retailers of credit who really operate "at the frontier" justified in charging effective real interest rates of close to 100 percent (on an annualized basis) in order to cover their costs? In view of the fact that such policies are being pursued, it seems difficult to discuss interest rate restrictions separately from the issue of the efficiency of credit retailers.

D. von Pischke (eds.): Undermining Rural Development with Cheap Credit, Boulder, Col.: Westview Press 1984, pp. 78 - 95.

V. Frontier Development

Part III on "structural considerations in frontier development" discusses informal finance (chapter 8) and innovation (chapter 9). Chapter 10 combines the two concepts and draws strategic implications.

It would be wrong to believe that there is nothing beyond the frontier which forms the outer edge of the area in which formal financial institutions currently operate. Indeed, beyond the frontier lies the domain of informal finance, a subtle and extremely complex web of financial relationships and a multitude of financial arrangements and financial institutions. Often informal finance is simply ignored or discredited by development planners. The common and erroneous notion that the main operators in informal financial markets are "malicious moneylenders" (p. 174) is an indication of both ignorance and hostility. It is important, according to *von Pischke,* that those who want to shift the frontier outward understand the existence as well as the specific strengths of informal finance. Such specific strengths must in fact exist, since, after all, informal financial markets create "value for the people" (p. 173) under conditions where formal financial institutions either fail or do not even try to operate. And these specific strengths are essential at and beyond the frontier, "because (formal) intermediaries' rationale for passivity, that conventional services are unlikely to be profitable when offered to frontier clients, is a correct commercial assessment" (p. 199).

If there were a vacuum beyond the frontier it would make sense to order formal financial institutions to broaden the range of people and firms which they try to serve, or to talk them into simply pushing ahead. That is exactly what has traditionally been done by development planners and politicians. The results of this strategy have been disappointing because it was based on an incorrect diagnosis of the problem. *Von Pischke*'s diagnosis is that conventional formal finance is not competitive at the frontier. This insight leads to drastic consequences. Simply expanding conventional financial services cannot succeed. If they are to operate successfully, i.e. without constant losses, at the frontier, it would seem that formal financial institutions have only two options. One would be to adopt as much as possible of the techniques and instruments of informal finance. However, it is hard to imagine how this could be done successfully "in the commercial bank or development bank format with modern offices, national wage scales, and unionized staff" (p. 220) and under the obligation to comply with modern commercial and banking laws. The other option – and in fact the only realistic option – is innovation: "Structural innovation" is an absolute necessity for any attempt to expand the frontier. Innovation must create value for customers as well as for intermediaries. It should reduce transaction costs of the customers and intermediation costs of the institutions; and it should create confidence and reduce risk.

Chapter 10 provides new and interesting interpretations of common concepts of development finance in the light of "structural innovation" and recounts the story of the Grameen Bank as an institution which has been successful because it understands that "continued innovation (is) a necessity" (p. 232).

The basic line of reasoning in part IV follows directly from this clear and innovative foundation. This part of the book is about implementing the idea that only innovations which create value can push the frontier outward. First of all, lending strategies are analyzed and assessed in chapter 11. Asset-based lending is what conventional lenders do. Character-based lending is what the informal lenders do, according to *von Pischke*. And cash-flow lending is what formal financial institutions who want to operate profitably at the frontier should do. Cash-flow-based lending is difficult; it requires that the lender be able to assess and reduce risk. Risk assessment in the form of debt capacity calculations is discussed at length and in very operational terms in chapter 12. However, debt capacity is not simply a given. Indeed, it can and should be created and developed within the context of a credit program. Confidence is the key variable for all efforts to strengthen the debt capacity of frontier customers.

Because of the clarity of the basic arguments and because of the many insightful details, chapters 11 and 12 on risk, debt capacity and confidence are among the best chapters of the book. Program planners are well advised to learn these lessons very carefully. It would seem that there is no alternative to designing credit programs, building relationships between lenders and customers and even making specific lending decisions with a view to the kind of debt capacity considerations which *von Pischke* develops in these two chapters. Unfortunately, though, reality happens to be different. *Von Pischke* is right in calling "the design of most frontier assaults by official credit programs ... primitive" (p. 269) as they systematically disregard the dimension of risk and confidence. It is an even harsher criticism of his fellow professionals that, in concluding his most elementary first presentation of the concept of debt capacity, *von Pischke* states that "calculations and considerations such as these are novel and virtually never undertaken by project designers and employees of state-owned credit institutions in developing countries" (p. 288). The ultimate responsibility for such a lack of professionalism rests with the experts and decision makers in the donor agencies of the industrial countries. They do not insist on the application of reasonable professional standards. It should be added that not only official credit projects are deficient because they do not adequately consider risk, confidence and debt capacity; unoffical, e.g. NGO-sponsored credit programs, are certainly not any more sophisticated in this respect.

Chapters 11 and 12 focus on the relationship between financial intermediaries and their customers at the frontier. Chapter 13 shifts the focus to the financial intermediaries and adds another dimension: the relationship between these intermediaries and the institutions in donor countries which fund them and use them as channels for funds. Sound credit programs have to meet not only the "borrower criterion" but also the "intermediary criterion" (p. 315): Participation in a donor-initiated credit program must be profitable or, technically speaking, have a positive net present value for the intermediary in question. This requirement is often not fulfilled. As the author explains with reference to a recent study by *Leila Webster,*[8] "the costs and risks of lending at the frontier are substantial ... administrative overheads frequently amount to 20 percent of the amount loaned", and the losses resulting from arrears and delinquency are typically above 3 percent (p. 313). *Von Pischke* deduces from these estimates that donor agencies should appreciate these difficulties of the intermediaries and accept interest rates charged by them which cover these costs and, of course, the cost of funds.

Donors bear responsibility for ensuring that they do not lead intermediaries at the frontier into difficulties by making them participate in credit programs which turn out to be unprofitable for them. If the "intermediary criterion" is not met, a credit program should either not be started in the first place or it should be discontinued. In *von Pischke's* own words, "Just say NO to money-losing credit projects!"

The concluding chapter of the book "provides a framework for determining the effectiveness of policies and projects that attempt to create value at the frontier" (p. 317). This chapter, which is much more technical in content and style than the earlier chapters, contains a thorough introduction to monitoring and evaluation. Who should monitor and evaluate performance? First of all, it is in the participating financial intermediaries' own interest to see where they stand and what impact the participation in a donor-initiated project has on their financial health. But also the donors must evaluate and

[8] See *Leila Webster:* World Bank Lending for Small and Medium Enterprises: Fifteen Years of Experience, Industry and Energy Department Working Papers, Industry Series, No. 20, Washington D.C.: World Bank 1989.

monitor what their intervention is doing to the beneficiaries, i.e. the customers, and, what is more important, to the participating intermediaries. The emphasis on monitoring and evaluation at the level of the financial institutions is a logical consequence of *von Pischke*'s urgent plea that "the primary importance now accorded to the amount of credit delivered (be) replaced by attention to indicators of the vitality of financial intermediation" (p. 316). It should be recalled that conventional development finance has not supported but rather undermined financial intermediation in the countries which were supposed to benefit from foreign intervention.

VI. Summary and Concluding Assessment

Von Pischke's "Finance at the Frontier" is indeed a very stimulating book. However helpful and interesting the details in every chapter and on almost every individual page may be, this is not the fundamental achievement of the author. To the present reviewer, the main achievement appears to be that *von Pischke* has been able to develop a strictly consistent framework. It is not only a conceptual framework, but also a practical and policy-oriented framework. "Finance at the Frontier" can serve as a guide to better policies and practices for those who are responsible for an important field of international cooperation. The framework has the additional advantage of being absolutely convincing to the reader. Of course, the book will not be universally applauded. Its explicit as well as implicit criticism of what most donor agencies in industrial countries and most credit retailers in developing countries are presently doing is harsh. It will certainly anger those who are responsible for the past and current failures in the field of development finance for the poor. The book shatters too many of their favorite beliefs.

Without being naive, "Finance at the Frontier" is an optimistic book. It is shaped by the author's conviction that serious banking for the poor is not only possible but also valuable for clients and intermediaries. Although informal finance is by no means systematically "deficient for 'development'" (p. 213), it would be good to expand the realm of formal finance. Banking for the poor has to be strict banking. Any other approach will lead to a romantic dead-end. The present reviewer shares these views without any reservation.

No book is without weaknesses. It appears that *von Pischke* is a bit too optimistic in his assessment of the difficulties which have to be overcome at the level of the financial intermediaries operating at the frontier. His optimism seems to reflect his professional experience at the World Bank, where he works mainly on projects in Asia. Asia is a special case. Almost all of the limited number of success stories in the area of development finance are from Asia.[9] And the World Bank funds almost exclusively somewhat established partner isntitutions which exhibit at least some professionalism and enjoy certain economies of scale. World Bank lending to small and medium enterprises rarely consists of funding the smallest operations of the Grameen Bank type. It is surprising to read that *von Pischke* considers administrative costs of 20 percent and loan losses in the range of five percent as high at the frontier, that he regards these costs as an indication of the difficulties of frontier lending and that he pleads that donors should understand and accept intermediaries' high interest rates as necessary to cover these costs. With the total cost of administration and risk not above 25 percent, it is not too bold to ask that "appropriately priced loans should be remunerative to the lender" (p. 313), and that efficiency should be rewarded with survival.

In other parts of the world and in projects sponsored by other donors, the situation seems to be more difficult. Preliminary findings from an ongoing investigation of NGOs who retail credit to the "informal sector" in Latin America indicate that "20 plus 5" percent would be a fantastic performance. Only one of the NGOs covered in the investigation had administrative costs and estimated risk costs below 40 percent. The sample average was around 80 percent.[10]

Besides demonstrating that some environments in which financial intermediaries operate may be more difficult than others, such figures indicate problems of a type which *von Pischke* does not address systematically: These retailers of credit cannot be regarded as established institutions with a life of their own. Instead, they owe their existence to the international donor community's demand for such intermediaries, and to its willingness to provide funding to them. The donors need such institutions for various reasons, and they seem to be prepared to pay for their apparent inefficiency. The problem is this inefficiency: At least to some extent, the inefficiency appears to be a consequence of the ill-conceived governance structure of these intermediaries. Economically speaking, the donors own these NGOs because all the funds come from them and they absorb all risks and losses. They keep the intermediaries alive, but they treat them as though they did

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[9] See the selection of success stories covered in Jacob Yaron: Assessing Development Finance Institutions, World Bank Discussion Paper 174, Washington D.C.: World Bank 1992.

[10] The investigation has been undertaken by Interdisziplinaere Projekt Consult (Frankfurt) on behalf of the Inter-American Development Bank. Publication of the results is in preparation.

not depend on donor interventions for their existence. The donors do not live up to their responsibility as de facto owners, and ultimately no person or institution has a genuine incentive to see to it that the intermediaries not only survive but achieve at least a minimum of efficiency. There is no link between survival and efficiency in such cases, and survival is not the reward for efficiency.

The general lesson which can be drawn from this special case is that an important element of the intermediary-focused strategy, which *von Pischke* rightly advocates, should be the economic analysis of the types of intermediary institutions which are involved in all efforts to push the frontier forward.[11] Donors can and should do more than select, fund and monitor intermediaries. They should try to make them more efficient – and more efficiency-oriented – by shaping their incentive and governance structures. In his earlier writing *von Pischke* showed how donors weaken intermediaries by providing them with negative incentives. It would be very much in the spirit of his new book if donors started to think more about creating positive incentives.

Zusammenfassung

Finance at the Frontier

J.D. von Pischke, als Mitarbeiter der Weltbank selbst ein „Praktiker", ist einer der Wortführer der kleinen Gruppe von Autoren, die vor etwa zehn Jahren die gängige Praxis der Entwicklungshilfe im Bereich des Finanzwesens einer radikalen Kritik unterzogen haben. Sein neues Buch „Finance at the Frontier" verdient allein deshalb größte Aufmerksamkeit, weil es den ersten Versuch darstellt, im Rahmen einer größeren Monographie die damalige auf rein neoklassische Argumente gestützte Kritik aus heutiger Sicht erneut zu diskutieren und konstruktiv zu wenden.

„The Frontier" ist die Grenze, an die das formelle Finanzsystem in Entwicklungsländern stößt, wenn es versucht, die Masse der Kleinbetriebe und Kleinbauern zu erreichen. *Von Pischkes* Kritik der Praxis ist nach wie vor radikal. Doch ihre Grundlage und ihre Stoßrichtung haben sich verändert: Nicht mehr Regulierungen per se sind schuld an den zahlreichen Mißerfolgen einer entwicklungsfördernden Finanzsektorpolitik, sondern das Unverständnis der Entwicklungspolitiker und -bürokraten für die spezifischen Anreiz- und Informationsprobleme, die Finanzbeziehungen – zumal solche im sogenannten informellen Sektor der Entwicklungsländer – prägen. Diese Probleme bilden auch den Ausgangspunkt für die vom Verfasser entwickelte erfolgversprechende Konzeption, wie es möglich ist, „to push the frontier outward".

[11] See *Jan Pieter Krahnen; Reinhard H. Schmidt:* Development Finance as Institution Building, Boulder, Col.: Westview Press 1993 (in press).

Summary

Finance at the Frontier

About ten years ago, *J. D. von Pischke,* a senior officer at the World Bank, had vigorously attacked the prevailing policies in the field of development finance. His recent book "Finance at the Frontier" is the first comprehensive attempt to rethink and reformulate the former critique, which had been based on purely neoclassical reasoning, and to derive constructive implications for a sound financial sector policy in developing countries from this critique. "The frontier" is the limit beyond which formal financial institutions are unable to provide services to the millions of poor people in the developing world. The book is about the nature of this frontier and ways to shift it outward.

Von Pischke's critique is a forceful as it has ever been. But its theoretical basis as well as its focus have changed. Misdirected regulation per se is no longer regarded as the fundamental reason why almost all development aid efforts in the field of finance have been unsuccessful in recent years. Instead, von Pischke now sees the main factor in the failure of development policy makers and administrators to understand the specific information and incentive problems which make any financial relationship precarious and which are particularly difficult to overcome in the environment of the informal economy of a developing country. This change in the conceptual basis of the critique provides the natural starting point for a very promising new approach to development finance policy.

Résumé

Finance at the Frontier

J. D. von Pischke, en sa qualité de «senior officer» à la Banque Mondiale, est un praticien expérimenté. Mais il est aussi une des figures de proue d'un petit groupe de chercheurs qui s'est distingué il y a dix ans de cela par une critique radicale des conceptions appliquées aux projets de financement dans le domaine de l'aide au développement. Son nouvel ouvrage «Finance at the Frontier» revêt un intérêt particulier car il représente la première tentative de reprendre et de repenser entièrement ces thèses critiques, basées à l'époque sur des arguments purement néoclassiques, pour en tirer des conclusions et des enseignements très utiles à la définition de politiques de financement dans des économie en voie de développement.

La «frontière» de *von Pischke* est celle au delà de laquelle le secteur financier formel s'avère incapable de fournir des services utiles aux millions de petits commerçants, artisans et paysans qui forment les forces vives des économies en voie de développement. L'analyse que fait l'auteur des pratiques de financement n'a certe rien perdu de son mordant. Cependant, ses bases théoriques et sa direction ont changées: Les pratiques interventionnistes ne sont plus considérées comme étant en soit la cause de tous les déboires en matière de financement du développement. Le principal facteur d'échec est bien plutôt l'incapacité des fonctionnaires et politiciens du dévelop-

pement de reconnaitre et de comprendre les impulsions et la nature des problèmes de communication qui déterminent les relations financières, notamment dans le secteur réputé informel. C'est à partir de ce constat fondamental que l'auteur développe des conceptions très prometteuses quand aux moyens à mettre en œuvre pour faire reculer la «frontière».