

**EVALUATION OF A KOREAN MICROFINANCE PROGRAM:  
THE SAEMAUL CREDIT COOPERATIVE MOVEMENT  
IN THE 1960S AND 1970S**

**By**

**SIM, WOO JONG**

**THESIS**

Submitted to

KDI School of Public Policy and Management

in partial fulfillment of the requirements

for the degree of

**MASTER OF DEVELOPMENT POLICY**

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## **ABSTRACT**

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The purpose of this study is to reveal whether the Saemaul Credit Cooperative (hereinafter SMC) Movement, the Korea's representative microfinance movement, was successful and can serve as a model for development cooperation. To do that, this research evaluated whether there is positive impacts of SMC on income increase or poverty reduction of Korean rural area in 1970s. Through regression analyses, this research showed SMC gave positive effects not only on income increase of the rural people, but also Saemaul Movement (hereinafter SMU). After that, this research revealed what features of SMC make difference from other MFIs, especially comparing with Grameen Bank. They are nationwide movement, self-reliant, self-established, and bottom-up movement, saving-oriented movement, micro-credit movement (with small & credit loans, sound purpose, and low interest rate), education-first movement, and virtuous circle movement through income increase projects.

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## I . Introduction

The purpose of this study is to reveal whether the Saemaul Credit Cooperative (hereinafter SMC) Movement, the Korea's representative microfinance (MF) movement, was successful and can serve as a model for development cooperation. In fact, according to many anecdotes, microfinance is known as playing an important role in reducing poverty and establishing economic viability for have-nots. However, microfinance has continuously caused a stir in its impact evaluation, regarding selection bias, failure of controlling variables, etc. Nonetheless, there were few suggesting an alternative.

Because of that, this study will show a good case on the evaluation of a MF movement, which was delivered about 50 years ago in Korea's rural area and is currently underway. The evaluation of this study will be based on statistical analyses rather than anecdotes. "That is because the anecdotes are culled to show the potential of microfinance, while the statistical analyses are designed to show typical impacts across the board." (Armendariz and Morduch 2010) Through this analytic evaluation, this study will show how successful SMC was, in other words, how much SMC contributed to poverty reduction in Korean rural areas in the 1960s and 1970s. And after that, this study will reveal the features which have made such a successful story, mainly comparing with another successful case, Grameen Bank.

Therefore, the research hypothesis of this study is that the SMC Movement had successfully reduced poverty and improved the economic viability of the rural people. In fact, during the 1960 – 1970 Korean economic development periods, the SMC Movement played a pivotal role in reducing poverty and improving economic viability of the poor, especially in the rural areas. And the second hypothesis is that there are several features for the success of SMC.

To do that, this research uses regression analyses and descriptive analyses. As indicators for assessing this microfinance institution (MFI), this research evaluates whether SMC reduced rural poverty and improved rural household income or how much it did.

The next section offers a brief literature review on the estimation of MFIs and the discussion of MF's pros and cons. The third section describes the variables and methodology

to prove the hypothesis of this study; the following section is the result of an empirical analysis. And after that this research shows several features for the success of SMC. The last section is a conclusion and recommendations of this research.

## **II. Literature Review**

There are many studies on MFIs, especially on the Grameen Bank. For a start, this study scans these previous studies and checks the concept and role of microfinance. And then, we will look into discussions of the pros and cons of the effectiveness of the Grameen Bank. And finally, we will show why the study on SMC is necessary.

### **1. Concept and Role of Microfinance**

Microfinance enhances the accessibility of financial services for the poor in remote rural areas. Otero (1999) defines Microfinance as “the provision of financial services to low-income poor and very poor self-employed people.” In general, microfinance contains various kinds of financial services such as loans, saving, and insurance. According to Ledgerwood (1999), microfinance services “generally include savings and credit, but can also include other financial services such as insurance and payment services.”

Meanwhile, microfinance plays an important role in reducing poverty and establishing economic viability for have-nots. UNCDF (2004) states that

Studies have shown that microfinance plays three key roles in development. It (i) helps very poor households meet basic needs and protects against risks; (ii) is associated with improvements in household economic welfare; (iii) helps to

empower women by supporting women's economic participation and so promotes gender equity.

And also, Otero (1999) illustrates that, "microfinance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organization-building, enables people to move out of poverty."

More recently, Simanowitz and Brody (2004) stated that, "Microfinance is a key strategy in reaching the MDGs and in building global financial systems that meet the needs of the most poor people."

After all, if we put aside the empirical verification, it is common sense that microfinance is one of the most useful methods to help the poor and one of the most important issues to be discussed in the development arena.

## **2. Effectiveness of MF: Case of Grameen Bank (GB)**

Among many MFIs, the most well-known institution is the Grameen Bank. Especially after 2006 when the Grameen Bank and its founder, Muhammad Yunus, won the Nobel Prize, "Yunus and the Grameen Bank began to prove that microfinance is a viable method to alleviate poverty." (Sengupta and Aubuchon 2008) And most studies on Grameen Bank have evaluated it as the most successful MF model. Because of that, many ODA organizations have followed the Grameen Bank model to replicate it in other developing countries. As a result, the Grameen Bank's model of microcredit, along with its vision of empowering the poor, has drawn widespread recognition in recent decades and is being adopted by many countries around the globe. (Yasushi Suzuki 2011)

The Grameen Bank model, however, has some problems such as its subsidy dependency and weak sustainability. For instance, revealing GB's adjusted default rate (7.8%), Morduch (1999) raises the important issue of validation and at last makes the point that "the rate is still impressive relative to the performance of government development banks, but it is high enough to start creating financial difficulties in GB." (Morduch 1999, 1590)

In spite of these ambiguities regarding GB's effectiveness and sustainability, many MFIs have followed the GB model. This phenomenon has resulted in some skepticism on MF movement in the international development arena. The main reason of this happening is that there is no objective, statistical, and wholly acceptable analyses on the effectiveness of MF. In other words, "There is no study yet that has achieved wide consensus as to its reliability." (Armendariz and Morduch 2005) As a result, it is highly required to conduct the well-designed analysis, find an effective model, and benchmark it.

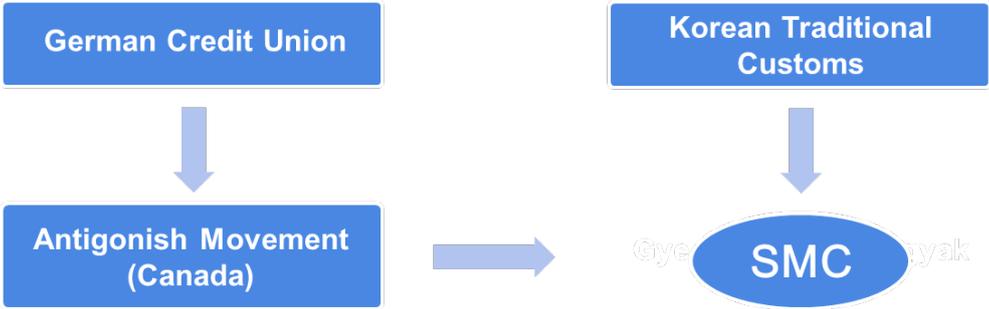
### **3. One of the Most Successful Microfinance Cases: the SMC Movement**

In spite of these debates on the effectiveness of Grameen Bank or MFI, Korea has her own successful microfinance case: the SMC Movement. In the 1960s and 1970s, the Korean economic development period, the SMC Movement played a pivotal role in alleviating poverty, especially in the rural area of the country. When it comes to the history of microfinance, however, researchers have not shed any light on the SMC Movement as a microfinance model. Even according to many researchers such as Robinson (2001) and Otero (1999), microfinance is regarded as first coming to prominence in the 1970s, whereas the SMC was originated in the early 1960s and showed rapid growth in the 1970s.

SMC was first established in South Gyeongsang province in South Korea. As a matter of fact, SMC is a sort of credit cooperative. Hence, like other credit cooperatives, SMC was

also influenced by western cooperative like Germany’s Raiffeisen and Canada’s Antigonish in the early 1960s. SMC, however, has very different characteristics from those western cooperatives. When they accepted the ideology from the West, Koreans integrated it with indigenous Korean customs like *Gye*, *Hyangyak*, and *Doora*,<sup>1</sup> which are kinds of community contract to enhance community member’s economic, social status by using community’s blood tie and cooperation. And they recreated their own ideology and system. That is SMC. Based on its traditional background, SMC could easily reach out to people in rural area and achieve its goal: rural income increase through poverty reduction and empowerment (capacity building). At the time, as a result, SMCs were a key source of credit for farmers. (Kim, Joonkyung 2013)

[Figure 2-1] Origin of SMC



And also, the SMC received few subsidies from the government. Furthermore, the SMC has sustainably developed so that the company has more than three thousand branch offices

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<sup>1</sup> Gye : sort of private fund, whose members chip in a small amount of money and take turns to receive a lump sum share  
 Doora : kind of labor cooperation among farmers  
 Hyangyak : social contract

nationwide and its members include one third of the Korean People. In other words, the SMC Movement appears to be one of the most successful microfinance models in Korea.<sup>2</sup>

#### **4. SMC: Evidence of the successful microfinance movement?**

Based on outstanding outcomes such as its performance, socio-economic impacts on rural households, and its financial sustainability, the SMC could be considered apparent proof of the success of the microfinance movement.

My initial investigation, however, has found that there has been little research on the SMC Movement, especially from the perspective of microfinance. Even though there are some studies, they focused on specific topics: development strategy of SMC (Whang 1991); SMC's role in constructing modern welfare society (Whang 1990); and promoting the local economy (Choi et al. 2007). At best, there is a study comparing similarities and differences between microfinance and credit cooperatives (Jang 2011). Park et al.(2005) attempted a quantitative analysis on regional income increase by using the number of financial institutions like SMC for the first time, but the target period is after 1998 and the analysis was not only for SMC, because other banks were considered together with SMC. There are also other studies on SMC's impact on income increase like Bae (1975) and Woo (1998). However, their studies are focused on several villages, thus they are short of samples. Rather, Hong(1975)'s samples are more broad. Nevertheless, his analysis has also some limits in that the sample area is restricted in Jeonbuk province and research methods depend only on survey.

More recently, in his paper, Kim, Jungho (2013) said "A community credit union [SMC] plays a vital role in all the economic activities and the accumulation of assets in a rural area."

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<sup>2</sup> SMC's members reached out 15 million as of the end of 2013.

However, his paper just aimed at examining how much Village Leader Training Program could influence the performance of SMC. In a nutshell, in spite of its successful outcomes, there is no research to verify the effectiveness of the SMC Movement in terms of its MF activities.

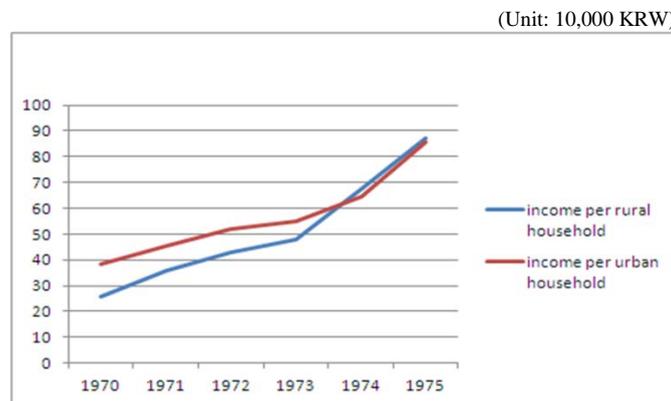
Against this backdrop, therefore, the purpose of this study is to reveal how much the SMC (MF) Movement was successful and to define what the main factors are contributing to the success, based on the quantitative analysis and simple tabular analyses.

### III. Empirical Analysis

#### 1. Methodology

In the late 1970s, as Figure 3-1 is showing, income per household was abruptly increased. At the same time, income per rural household even exceeded urban household's one in 1974. This means that some factors caused the abrupt increase of household income, especially rural household income.

[Figure 3-1] Income per household



Source: Ministry of Home Affairs (1980)

In this context, rural savings distribution (as shown in Table 3-1) suggests meaningful message. Among the whole rural savings, the share of SMC has continuously increased and ended up exceeding that of Agri-fishery Co-ops in the late 1970s. It means that there is a possibility for SMC and rural household income to be correlated.

[Table 3-1] Rural savings distribution

(Unit : 1,000 million KRW)

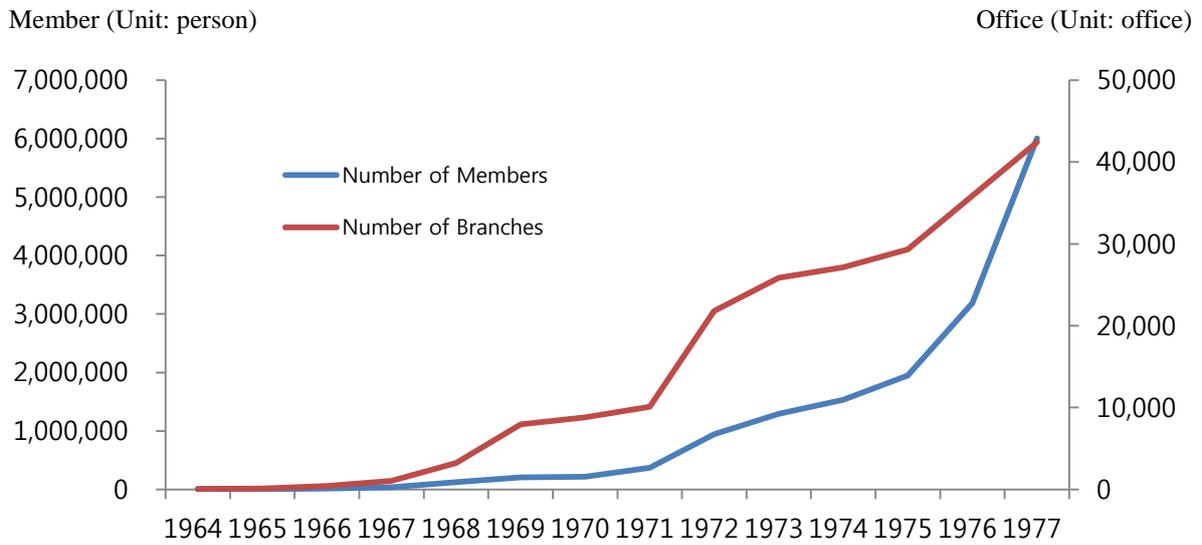
Year	SMC(A)	Agri-fishery Co-ops(B)	A/B(%)
1971	2.7 (100.0)	18 (100.0)	15
1972	3.6 (129.6)	15.3 (85.0)	24
1973	6.5 (240.7)	35.9 (199.4)	18
1974	3.4 (125.9)	56.0 (311.1)	6
1975	7.4 (270.1)	77.7 (431.7)	10
1976	22.2 (822.2)	113.9 (632.8)	19
1977	71.1 (2,633.3)	185.5 (1,030.6)	38
1978	240.0 (8,888.9)	212.4 (1,180.6)	113

Note: Parentheses means index based on 1971

Source: Revised table from Hwang (1980).

When we consider the number of SMC's members and offices (see Figure 3-2), we can find some similar trend with the path of rural household income. As a result, we can assume that there is some relationship between income per rural household and SMC. Against this backdrop of correlation between two, this research will reveal if SMC contributed to reduce poverty and enhance income per rural household in 1970s.

[Figure 3-2] SMC's members and offices



Source: SMC statistics

To reveal such SMC (MF) effectiveness on rural income increases, this research will evaluate whether there is a positive relationship between the income level of a rural community and SMC activities of the same community in 1970s.<sup>3</sup> To do so, this research considers a specific model as follow:

$$I_{i,t} = \beta_1 + \beta_2 SMC_{i,t} + \lambda X_{i,t} + \varepsilon_{i,t}$$

*“where the dependent variable  $I_{i,t}$  means the income of a region  $i$  in a specific time period: year  $t$  and  $SMC_{i,t}$  stands for the amount of SMC’s asset, which serves as the main independent variable of the model;  $X_{i,t}$  means other independent variables, which can be considered as influential factors for*

<sup>3</sup> In the case of the 1960s, there is lack of data. So, in chapter III. Empirical Analysis, this research just focused on the 1970s.

*income increases like the number of household stocks, farming equipment, cultivating areas, human capital, etc. and  $\varepsilon_{i,t}$  stands for the error term.”*

If there is some positive impact of SMC on rural income increase,  $\beta_2 > 0$  will be likely to be expected from the above formula.

## **2. Data**

### **2.1. Dependent Variables: Income Indices**

For the dependent variable, which stands for rural income, average income per household or rural household by *Goon*<sup>4</sup> unit is needed. Unfortunately, however, there is no specific data regarding rural income in 1970s. As a substitute data, this paper will use 1) the ratio of self-reliant village to the total number of villages and 2) the rice productivity, following Kim Jungho (2013)’s paper.

Self-reliant village was one of the criteria for classification of village by the government in 1970s. To be the self-reliant village, average annual income per household had to be over 1.4 million won.(see Table 3-2) According to this criteria, Kim Jungho(2013, 789) concluded “When income standard exists as promoting requirement, village level index can be interpreted to economic index.”<sup>5</sup>

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<sup>4</sup> *Goon* is the administrative unit of district in Korea.

<sup>5</sup> Kim Jung-ho(2013) said “Of course, applying real income allowed inflation rate for exact income index is a limitation.”

[Table 3-2] Criteria for Classification of Village

Project	Required Factors	
	Self-help Village	Self-reliant Village
1. Farm Roads	• Completion of Main Roads	• Completion of Main Roads
	• Reconstruction of Village Roads	• Building Of Bridges Shorter than 20 Meters Each
2. Housing Environment	• Roof Ameliorating: over 70%	• Roof-Remodeling: over 80%
	• Reconstruction of Main Ditches	• Fence-Remodeling: over 80%
3. Farming base	• Irrigation of Farmland: over 70%	• Farmland Irrigation: over 85%
	• Arranging of Small Rivers in Villages	• Remodeling of Small Rivers around Villages
4. Cooperation Level	• Community Hall, Storehouse, Workshop, etc.: More than One	• Building More than Two among Village Hall, Storehouse, Workshop, etc.
	• Village Fund: over 500,000 Won	• Village Fund over One Million Won
5. Income Projects	• Community Income Project: More than One	• Development of Non-farm Income Source
	• Average Annual Income per Household: over 800,000 Won	• Average Annual Income per Household: over 1.4 Million Won

Source: Ministry of Home Affairs (1980)

Since this village level index was used by the government to evaluate the village's performance in [of] Saemaul Movement [by government], 1) the ratio of self-reliant village can be used as a dependent variable representing the level of income of the community.

Regarding the rice productivity, Kim Jungho (2013, 818) also maintained: "Since rice is the single most important crop, its productivity can be interpreted as an indicator of the economic well-being in rural areas. In addition, the rice productivity is a real index rather than a nominal one, which implies that it does not need to be adjusted by the price level in areas or periods".

The data 1) the ratio of Self-reliant village is taken from Goon Unit Yearbook Database(2013) and the data 2) the rice productivity is assembled from Year Book of Agriculture and Forestry Statistics(1974~77).

## **2.2. Independent Variable: the Asset of SMC**

The main independent variable is the asset of SMC. Because asset of financial institution contains the size of outstanding loans, the asset of SMC can be a barometer of SMC's performance as a MFI. Based on Amos & Wingender (1993)'s empirical analysis that regional gross products is influenced by banks' loan in the US and Koo & Kim (1999) and Park et al.(2005)'s findings that financial development results in regional development, it is easily assumed that the size of the asset of SMC is a main factor for increasing income of a rural community.

Like the ratio of Self-reliant village, the data regarding the asset of SMC was [could be] also taken from Goon Unit Yearbook Database (2013). The data is concentrated in the late 1970s and even scattered in different *Goon* and different year. For instance, some *Goon* has its data of SMC's asset for 6 consecutive years from 1974 to 1980, but the other *Goon* has just one data in 1978. And also, according to Goon Unit Yearbook Database (2013), the data is not only categorized by SMC's asset but also by SMC's performance. Nonetheless, the data of SMC's performance can be substituted as the asset data, considering that the performance means balance sheets of SMCs and, therefore, some *Goons* alternately used both "performance" and "asset" to record the result of SMCs.

## **2.3. Other Control Variables**

What other factors can also effect on the regional income? In fact, there isn't enough data to use regarding this paper because of the lack of database in Korean statistics in 1970s. Fortunately, however, there are some data by *Goon* unit in Year Book of Agriculture and Forestry Statistics published by Ministry of Agriculture and Forestry. Among that data, this paper chooses the relevant data with income from Year Book of Agriculture and Forestry

Statistics (1974~80) such as working-age population as human capital, number of cow, farming equipment, cultivating land and length of expanded village road. This selection of data is based on various theories regarding economic growth like endogenous growth theory, production function theory, etc. This way of data selection was already used by Park et al. (2005)

#### 2.4. Descriptive Statistics of Variables

As a whole, the variables are unbalanced panel data of 19 aggregatable *Goons* during 7 years (from 1974 to 1980). For standardization, all independent variables are substituted as the value per 1,000 persons. Table 3-3 is the summary of the above explanation on independent variables.

[Table 3-3] Independent Variables for Rural Income

Variable	Variable coding	Source
SMC	SMC's asset size /population	Goon Unit Yearbook Database(2013)
Road	Expanded roads /population	
Work force	14~59 ages/population	Year Book of Agriculture and Forestry Statistics (1974~80)
N.cow	Number of cow /population	
Equip	Number of equipment /population	
Field	Farming field /population	
Pure farm	Number of Pure farmer /population	

Note: 'Pure farm' means the number of full-time farmer and part-time farmer whose agriculture income is more than 50% of total annual income.

And also, Table 3-4 shows the simple description on statistics of variables.

[Table 3-4] Descriptive Statistics of Variables

	N	Unit	Minimum	Maximum	Mean	Std. Deviation
Village	46	%	33.00	100.00	73.5000	17.50905
Rice	22	kg/1,000 persons	176	520	404.64	75.479
SMC	50	1,000 KRW /1,000 persons	101.00	21411.00	5689.9400	4705.29218
Road	50	km/1,000 persons	.00	9286.57	710.9852	1816.63778
Work force	50	persons /1,000 persons	51918.00	136782.00	88674.7800	21266.92749
N. cow	50	unit/1,000 persons	64.00	283.00	111.0000	47.10865
Equipment	47	unit/1,000 persons	2.00	112.00	15.5106	18.19445
Field	50	ha/1,000 persons	83.00	283.00	167.9200	43.00064
Pure farm	50	persons /1,000 persons	480.00	973.00	900.7400	90.54367
Valid N (listwise)	18					

### 3. Result of Analysis

#### 3.1. SMC for rural income

[Table 3-5] Regression Results

Independent variables		SMC	Road	Work force	N.cow	Equip	Field	Pure farm	N	Goon (郡)	R-squared
Dependent variables	Village	0.001** (0.001)	-0.003* (0.002)	0.78 (0.112)	0.027 (0.055)	0.477** (0.186)	-0.011 (0.110)	0.022 (0.042)	46	19	0.414
	Rice	0.024*** (0.006)	-0.004 (0.006)	0.518 (0.503)	-0.713 (0.643)	-1.340* (0.630)	0.253 (0.305)	-0.176 (0.147)	22	15	0.860

Note: \* significant at 10% level; \*\* significant at 5% level; \*\*\* significant at 1% level; standard errors are reported in parenthesis

As this study anticipated, SMC has positive impact on income increases of the rural people, the variable SMC has a significant coefficient at 5% level in the case of the ratio of self-reliant village and at 1% level in the case of rice productivity. According to this results, when the asset of SMC per 1,000 persons increases by 1,000 KRW, the ratio of self-reliant village and the rice productivity of *Goon* increase by 0.1% and 2.4%, respectively.

Regarding equipment variable, the results show opposite impacts on the income increase in the case of the ratio of self-reliant village and the productivity of rice respectively. Moreover, road expansion variable shows the gap of significant level. This result raises the possibility of biased assumption that all independent variables are exogenous. Therefore, this research conducts another analysis; two stage least squares regression analysis (TSLS). In this TSLS, independent variables are equipment and road expansion variables with the possibility that they are endogenous, while other remaining variables are instrumental variables. Table 3-6 shows the result of that analysis in the case of the ratio of self-reliant village, i.e., the equipment variable has a significant positive coefficient at the 10% level. When it comes to the productivity of rice dependent variable, the all variables are not significant.

[Table 3-6] TSLS Results

Independent variables		Equip	Road	N	Goon (郡)	R-squared
Dependent variables	Village	0.657* (0.356)	-0.014** (0.006)	46	19	0.13
	Rice	-0.972 (0.892)	-0.021 (0.013)	22	15	0.25

Note: \* significant at 10% level; \*\* significant at 5% level; \*\*\* significant at 1% level; standard errors are reported in parenthesis

Meanwhile, regarding expanded roads variable, it shows negative impacts on the income increase at every stage of analyses. This can be interpreted that the more the region is poor, the more there are roads to be expanded, because this variable shows the performance of length of expanded roads in some year.

### **3.2. SMC for SMU**

Category 1,2,3 and 4 of Table 3-2 are all related to performance of the Saemaul Movement (SMU). In fact, the ratio of self-reliant village was utilized as indicators showing how successful the Saemaul Movement is in the region. Therefore, the result of regression result of Table 3-5 also shows the relationship between SMC and SMU. As a result, it would be also concluded that SMC gave positive effects on SMU results.

## **IV. Features of SMC in Comparison with Grameen Bank**

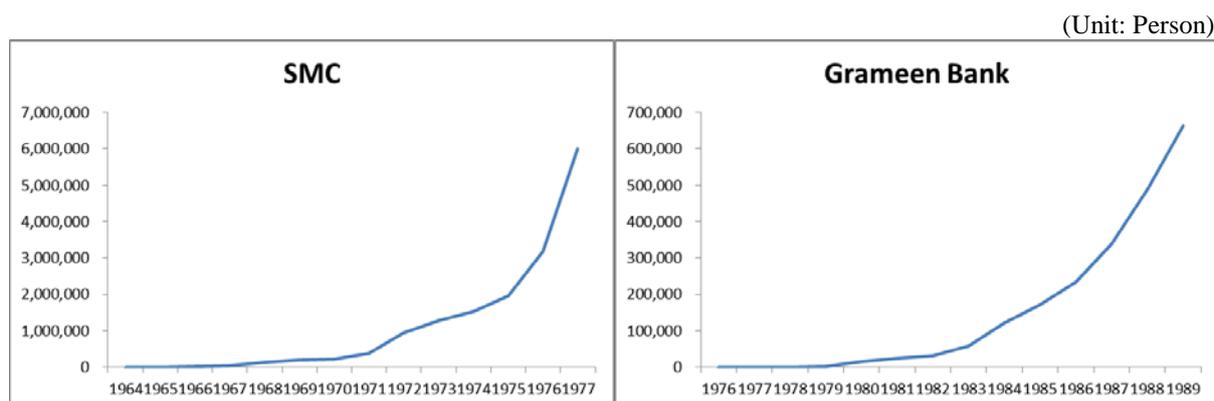
The analysis above shows SMC have meaningful effects on the income of rural people. These effects are based on several features of SMC, which are different from other MFIs. Therefore, this chapter reveals what the features of SMC are, comparing with other MFIs, especially Grameen Bank, which is designated as the most successful MF model. These features are the following: nationwide movement, self-reliant, self-established, and bottom-up movement, saving-oriented movement, micro-credit movement (with small & credit loans, sound purpose, and low interest rate), education-first movement, and virtuous cycle movement through income increase projects.

### **1. Nationwide Movement**

In general, many MFIs have been conducted in some selected area. No microfinance program lends to random citizens (Armendariz and Morduch 2010). As a result, their impacts are limited in coverage and weak to cover the national needs. On the contrary, SMC was a nationwide movement in 1970s. SMCs were established in every rural community at that

time. In 1977, the number of SMCs was 42,436, which was similar to the number of towns at that time. This means that every single town had its own SMC. In fact , “One Town, One SMC”<sup>6</sup> was a slogan of SMC movement.

[Figure 4-1] Number of Members



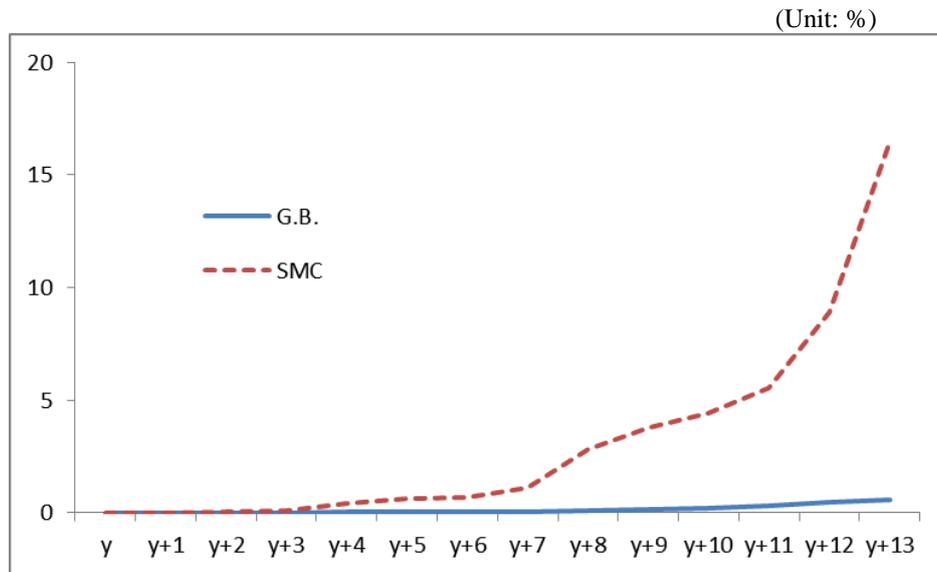
Source: SMC statistics, Grameen Bank Website

The Nationwide Movement feature of SMC is more apparent, compared to Grameen Bank. As shown in Figure 4-1, SMC and Grameen Bank draw similar shapes of growth when it comes to their numbers of members during the first 13 years of operation. However, based on the ratio of members of population (Figure 4-2), SMC widened its influence on the people by around 17%, unlike Grameen Bank’s 1%. This gap was reflected in the operational result as this study already showed in the previous chapter.

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<sup>6</sup> This slogan is very similar to “OVOP (One Village, One Product)” projects in recent development cooperation fields.

[Figure 4-2] Members over Population



Note: 'y' means the starting year of two organizations respectively.

Source: SMC statistics, Grameen Bank Website

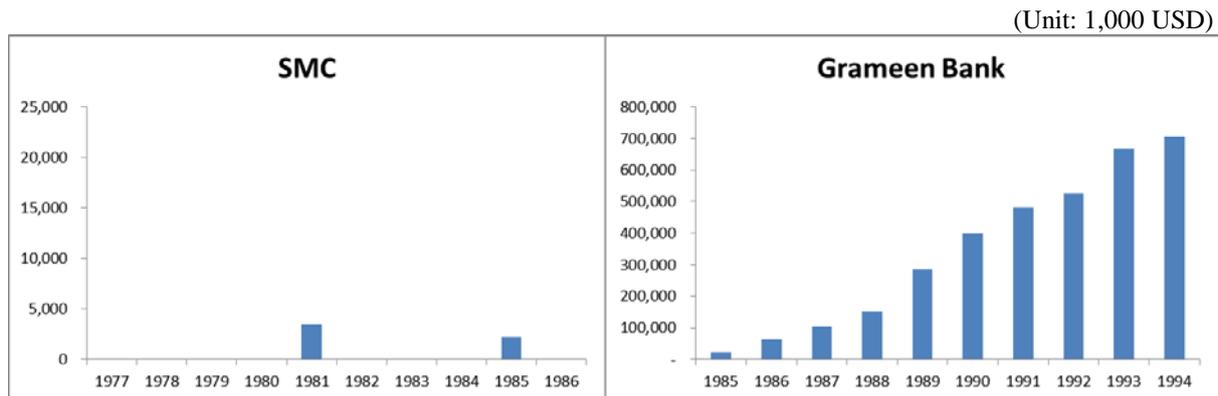
## 2. Self-reliant, Self-established, and Bottom-up Movement

To be expanded nationwide as is shown above, only the will of government is not enough. Voluntary participation is an essential factor. Furthermore, the problem of 'aid fatigue' mainly results from recipients' lack of self-reliance. In this regard, SMC is the best practice for the self-reliant, self-established, and bottom-up movement. SMC operation is based on internal funding such as shares and savings of its members. In contrast, most MFIs depend on external aid for its operation. Therefore, many MFIs cannot be sustainable without the continuity in these external funds. In this regard, Adams and Raymond (2008) illustrate, "Without subsidies, over 90 percent of microfinance operations would disappear in a few years".

Of course, there was support from the government or the Korean Federation of Community Credit Cooperatives (KFCC), which is the central supervisory institution for SMCs. But most support was no more than education or technical consulting. SMCs could

only be voluntarily established and developed based on consciousness reform of village leaders and villagers through continuous education. Even in the case of financial aid, the aid was characteristically meager and temporary.

[Figure 4-3] Subsidy state of SMC & Grameen Bank



Source: The 25 years history of SMC, Morduch(1999)

Figure 4-3 shows how small the subsidies SMCs received from the government were, especially considering its asset size (1,562 million USD as of the end of 1985). On the other hand, Grameen Bank’s subsidy dependency has continuously increased unlike SMC.<sup>7</sup> Table 4-1 shows the size of the subsidy for each institution as a percent of total assets, for instance in 1985.

[Table 4-1] Subsidy dependency ratio of SMC & Grameen Bank

(Unit: %, as of the end of 1985)

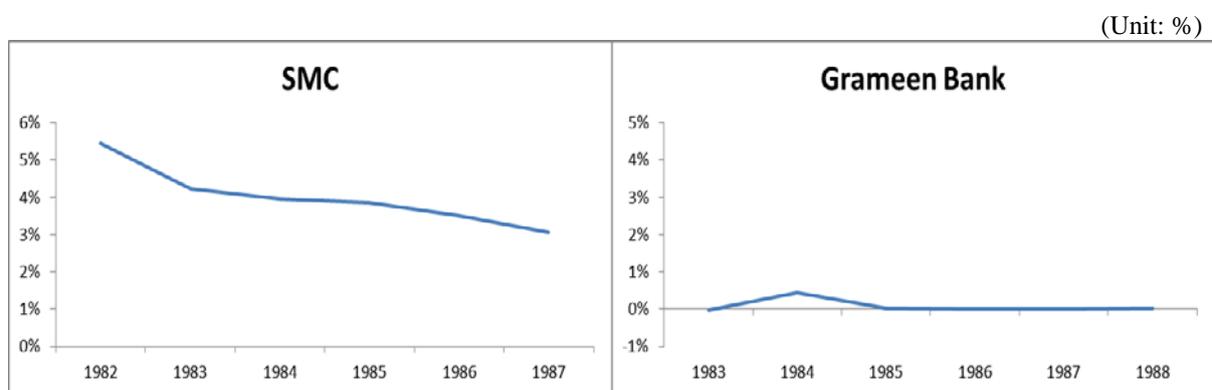
SMC	Grameen Bank
0.2	61.3

Source: SMC statistics, Grameen Bank Website

<sup>7</sup> Grameen Bank’s asset size is 3 million USD as of the end of 1985.

As a financial institution, this causes a severe problem. Considering Grameen Bank's poor performance in terms of Return on Assets (ROA), which has been nearly zero (see Figure 4-4), Grameen Bank shows critical weakness when it comes to financial soundness and sustainability.

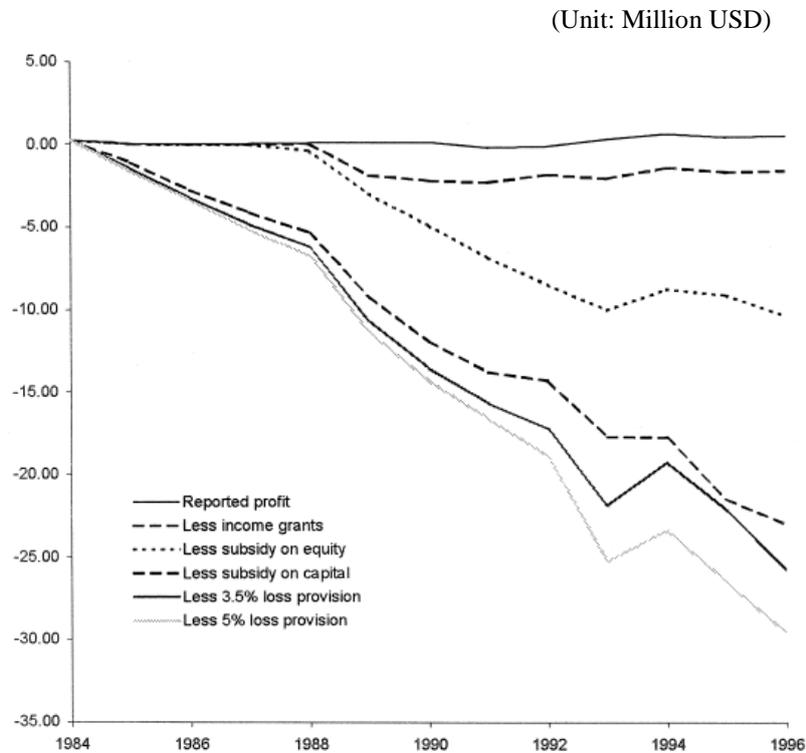
[Figure 4-4] ROA(Return on assets)



Source: The 25 years history of SMC, Grameen Bank Website

Analyzing this point, Morduch (1999) also revealed that G.B. had recorded losses and the amount of losses had increased every year (see Figure 4-5). Meanwhile, the most famous and representative MFI's poor management result had lots of implications. Other MFIs are not much different from Grameen Bank's case. Thus, this financial dependency mainly results in the recent skepticism on MFIs. Against this backdrop, the case of SMC can shed bright light on the effectiveness of MFIs.

[Figure 4-5] Reported profit and adjusted profit of Grameen Bank

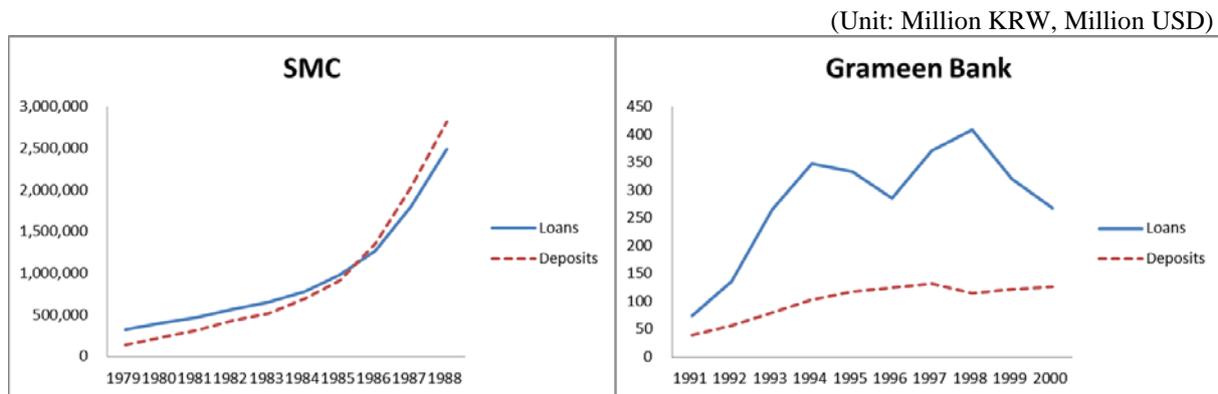


Source: Morduch (1999)

### 3. Saving-oriented Movement

What makes the largest difference between SMC and other MFIs like Grameen Bank? As mentioned above, the biggest difference is that SMC is oriented on saving, whereas other MFIs focus on loans. In this regard, SMC is a kind of saving movement rather than just micro-credit movement in its widest sense. As a financial institution, the component ratio between deposits and loans is very important, because it is highly related with financial dependency, and sustainability of the organization. Figure 4-6 shows deposits and loan statuses of the two institutions.

[Figure 4-6] Deposits & Loan Status



Source: SMC statistics, Grameen Bank Website

Like the case of Grameen Bank, as already mentioned above, any financial institution cannot help but depend on external aid, if it is without its own savings.

The representative case showing SMC's characteristic as a saving movement is the 'Squeezed Money Saving' campaign (see Table 4-2).

[Table 4-2] Examples of Squeezed Money Saving

saving by improving lifestyle	saving by reforming a way of thinking	saving by refraining from fashion items
<ul style="list-style-type: none"> <li>- saving by decreasing drink and smoke</li> <li>- saving by saving rice (<i>Jom-Do-Ri</i> saving)</li> <li>- saving by decreasing haircut cost</li> <li>- saving by collecting wastes</li> <li>- saving by reducing fares</li> </ul>	<ul style="list-style-type: none"> <li>- saving in a monthly meeting</li> <li>- saving due to diligence</li> <li>- saving due to management</li> <li>- saving with fixed income</li> <li>- saving by reducing household rituals (birthday, marriage, 60th birthday, etc.)</li> <li>- saving by joint project</li> </ul>	<ul style="list-style-type: none"> <li>- saving the performance of money excluding the extravagances such as private fund, necklace and ring consumption</li> </ul>

Source: Sim et al.(2012)

Among 'Squeezed Money Saving' campaigns, the most important example is *Jom-Do-Ri* saving (rice saving). *Jom-Do-Ri* saving is a way of saving in which rice was accumulated,

spoonful by spoonful, for the purpose of making a source of saving. Every time when housewives prepared meals, they would take out one spoonful of rice from a rice-cooking pot and put it in a jar placed at the corner of the kitchen for savings. At general assemblies or monthly meetings of SMC, housewives would bring the rice pot, and the SMC would take it and register it in the rice collection book. In this way, SMC motivated its members to make sources of saving in spite of the desperate and destitute situation. This is the most representative model of ‘Squeezed Money Saving’. In fact, this type of saving has been observed in some LDCs. Based on unique traits of Koreans like patience and perseverance, however, this campaign could achieve tangible results. Table 4-3 shows the empirical effects which were later reported in the then most influential daily newspaper; “Through the rice saving movement, symbolized as *Jom-Do-Ri*, around 450,000ℓ of rice were collected only in 1964.”<sup>8</sup>

[Table 4-3] *Jomdori* (rice saving) formula

<p><b>a family of 5 × 2 spoons = 10 spoons a day</b></p> <p><b>10 spoons × 30 days = 300 spoons a month</b></p> <p><b>▶ <u>300 spoons ÷ 40 spoons (1ℓ) = 7.5ℓ</u></b></p>
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Source: The 50 years history of SMC(2013)

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<sup>8</sup> Dong-a Ilbo, April 29, 1965.

By doing so, SMC played a pivotal role in fostering the saving habits of the rural poor. In order to alleviate poverty, the important thing is not only to give a loan, but also to nurture saving habits in the poor. Without saving habits, the poor have to be dependent on external subsidies and it is very difficult for them to help themselves and escape from poverty. As a result, these savings could be the seed for the rural to overcome poverty and increase incomes.

**4. Micro-credit Movement: Small & Credit Loans, Sound Purpose, and Low Interest Rate**

When it comes to loans, SMC shows many similarities with other MFIs. First, SMC lends money on a small loan basis. Therefore, in the then articles of association of SMC, there was a clause to give priority to smaller loans when two prospective borrowers compete for the loan.

Second, needless to say, the purpose of loan had to be sound. In addition to the aforementioned goal of MFI, poverty reduction, another important goal of MFIs is to improve the economic viability of the poor. To do that, loans can play a role of seed money, that is to say a sound purpose of loans. A lot of literatures regarding SMC also emphasize the need for a sound purpose for SMC’s loans on the part of the borrower. Table 4-4 shows examples of what were considered sound purposes for SMC loans<sup>9</sup> and they are very similar to Grameen Bank’s.

[Table 4-4] Purposes for loans

	SMC	Grameen Bank
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<sup>9</sup> With the slogan, ‘Let’s just find a business, SMC has enough money to lend’, SMC encouraged members to use loan of SMC for the sound purpose (Sim et al. 2012).

1	Farming Fund	41%	Milk	44%
2	Business Fund	24%	Cow Fattening	31%
3	Debenture Redemption	11%	Grocery Shop	25%
4	Medical / School Expenses	17%	Paddy Husking	0.2%
5	Etc.	7%	Rice/Paddy Trading	0.1%

Source: The 25 years history of SMC, Grameen Bank Website

Third, SMC's loans were mainly small credit loans, while other financial companies commonly dealt secured loans. This largely resulted from desperate poverty as SMC's members did not have any property to put up as collateral for loans in those days. Instead, with the consideration that there was the risk of a few defaults, SMC set importance on credit loans based on personal security, because debtors usually had a sense of community and fellowship. This was possible through mutual surveillance among members which resulted from the fact that they made a united effort to provide funding for the loans (as mentioned under the Saving Oriented Movement part). There was a cognition that "My savings are for your loan and your repayment is for my dividend." (Sim et al., 2012) And also, this cognition played a role as a kind of 'peer pressure'. This peer pressure based on ties of blood and region and was somewhat different from Grameen Bank's artificial grouping.

Furthermore, since each SMC performed in its own limited area like a clan society which is a feature particular to Korean Confucian culture, there was a psychological mechanism of

alienation or mutual surveillance in the case of default.<sup>10</sup> This was very helpful for SMC's outstanding performances.

[Table 4-5] Lending interest rate

SMC	Grameen Bank
13% (20~25%)	11 ~ 18%

Note: Figure in parenthesis refers to value before adjusted.  
Source: The 25 years history of SMC, Grameen Bank Website

Fourth, SMC shows very low lending interest rates, an annual rate of around 20 to 25 percent<sup>11</sup>, following the government's guideline. Admittedly, this rate is little bit higher than the reported rate of Grameen bank, an annual rate of around 11 to 18 percent.<sup>12</sup> In spite of that, it was very helpful for the rural poor who suffered from high rates demanded by loan sharks, which ran into an annual rate of around 60~72 percent.<sup>13</sup> Besides, the source of SMC's loans was totally different from Grameen bank's external aid as mentioned above. In addition, SMC, through several education programs, induced debtors to amortize rather than repay at one time. This encouraged them to repay the loans in a timely fashion. In doing so, SMC could raise awareness of "use lump sum money and repay small sum money" slogan<sup>14</sup> and helped members make it a habit to utilize financial services. Likewise, amortization reduced the actual interest rate from 25 percent to 13 percent as shown in Table 4-6.

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<sup>10</sup> This psychological mechanism has been equally applied to SMC's saving, education, and even participation in various kinds of SMC driven contributive projects discussed later so that this is very helpful for SMC's outstanding performances.

<sup>11</sup> Sim et al.(2012)

<sup>12</sup> Grameen Bank Website

<sup>13</sup> Lee Myunghwi (2010)

<sup>14</sup> Sim et al.(2012)

[Table 4-6] Repayment way and interest rate of SMC

(Unit: KRW)

Month	Principal balances	Monthly repayments			Notes
		Principal	Interest	Total	
1	12,000	1,000	240	1,240	Principal : 12,000 KRW Amortization : 12 months Monthly interest : 2%  By Monthly Repayments <b>Annual interest : 13%</b> Monthly : 1.08%
2	11,000	"	220	1,220	
3	10,000	"	200	1,200	
4	9,000	"	180	1,180	
5	8,000	"	160	1,160	
6	7,000	"	140	1,140	
7	6,000	"	120	1,120	
8	5,000	"	100	1,100	
9	4,000	"	80	1,080	
10	3,000	"	60	1,060	
11	2,000	"	40	1,040	
12	1,000	"	20	1,020	
Total	-	12,000	1,560	13,560	

Source: The 25 years history of SMC

## 5. Education-First Movement

The most important feature of the SMC movement has been education. As a matter of fact, this feature stems from SMC's characteristic as a cooperative. Unlike SMC, there is no special feature concerning education among other MFIs, even Grameen bank. However, education was emphasized ahead of other activities such as saving, loans, and even establishment of SMCs. Therefore, "Education first, establishment later" was a representative slogan of SMC in the 1960s and 1970s. In order to establish an SMC, villagers as well as village leaders and accountants-to-be had to participate in regular courses of education. Table

4-7 and Table 4-8 show well the amount of education conducted by SMC during the 20 years after its beginning.

[Table 4-7] Central Education

(Unit : Person)

Year	Total	Basic	Professional	Manager	Special
Total	141,804	80,610	25,800	18,904	16,490
1965	743	743			
'66	4,460	859			3,601
'67	1,332	1,332			
'68	705	705			
'69	2,528	2,528			
'70	3,673	3,673			
'71	5,789	5,789			
'72	4,576	4,576			
'73	9,536	9,536			
'74	2,723	2,723			
'75	2,254	1,250	846	158	
'76	4,999	2,749		1,550	700
'77	8,068	4,297		2,652	1,119
'78	8,269	2,818	3,989	904	558
'79	11,067	5,990	2,130	2,326	621
'80	11,676	4,419	2,740	2,258	2,259
'81	11,042	4,806	4,488	964	784
'82	9,411	6,590	1,564	841	416
'83	8,346	3,516	2,102	1,468	1,260
'84	6,944	3,430	1,879	425	1,210
'85	7,664	2,852	2,002	1,469	1,341
'86	7,190	2,319	1,734	1,760	1,379
'87	5,526	1,674	1,598	1,864	390
'88	3,283	1,438	728	265	852

Source: The 25 years history of SMC

[Table 4-8] Regional Education

(Unit : Person)

Year	Performance	Total	Note
1966	129,334	-	
'67	130,122	259,456	
'68	152,844	412,300	
'69	262,271	674,571	

'70	249,447	924,018	
'71	434,006	1,358,024	
'72	1,186,605	2,544,629	
'73	846,738	3,391,367	
'74	396,757	3,788,124	
'75	368,874	4,156,998	
'76	496,266	4,653,264	
'77	776,478	5,429,742	
'78	943,441	6,373,183	
'79	1,098,977	7,472,160	
'80	885,754	8,357,914	
'81	1,231,269	9,589,183	
'82	1,102,307	10,691,490	
'83	1,469,142	12,160,632	
'84	1,986,605	14,147,237	
'85	2,000,491	16,147,728	
'86	2,281,436	18,429,164	
'87	1,745,440	20,174,604	
'88.6	855,644	21,030,248	

Source: The 25 years history of SMC

Almost 20 million staff members were educated for 20 years and on average, 1 million staff members were educated every year. This education was very important for the staff of SMC in providing financial services, guidance, and even educating its members again. In the early stages of SMC, the devotion and efforts of the staff of SMC like the president and accountants, who often worked without pay, were the most important factor in making the SMC movement successful. For example, they visited members on a daily basis in order to encourage them to save small amounts of money and participate in general meetings or monthly meetings of SMC.<sup>15</sup> Needless to say, well-educated and motivated staff played a key role in creating SMC's success, and education served as the foundation.

When it comes to membership, education was a preliminary procedure for becoming a member of SMC. In general, members-to-be had to attend 9 hours of class, handling the

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<sup>15</sup> This tradition can be seen as a prototype of SMCs' current business practice to dispatch its staffs in the field to provide financial services like loans, saving, payment, etc.

purpose, procedures, rights and obligations of members, etc. Even after being a member, there was regular education in general meetings and monthly meetings. Through these educational opportunities, SMC could not only announce its news regarding SMC's performance, but also educate members of SMC to be empowered with agricultural skills and even democratic procedures. Even in the case of loans, debtors were obliged to receive education after, as well as before, getting a loan. In this way, education was a useful method for managing the repayment rate.

## **6. Virtuous Circle Movement through Income Increase Projects**

SMC contributed to increasing villagers' income in direct ways by conducting joint income increase businesses such as livestock breeding and joint farming.<sup>16</sup> In fact, SMC's Cooperate Social Responsibility (CSR) was not just sharing activities like fund donation, but village development activities. As the only representative organization of some villages<sup>17</sup>, SMC led village development projects including environment-improving projects and also income increase projects. This had a very important implication in that SMC played a pivotal role not only in fund circulation, but also fund generation by starting joint businesses for creating additional income apart from the traditional agricultural source of revenue.<sup>18</sup> Furthermore, these projects could make a virtuous circle for village development as well as SMC's sustainability as Figure 4-7 shows.

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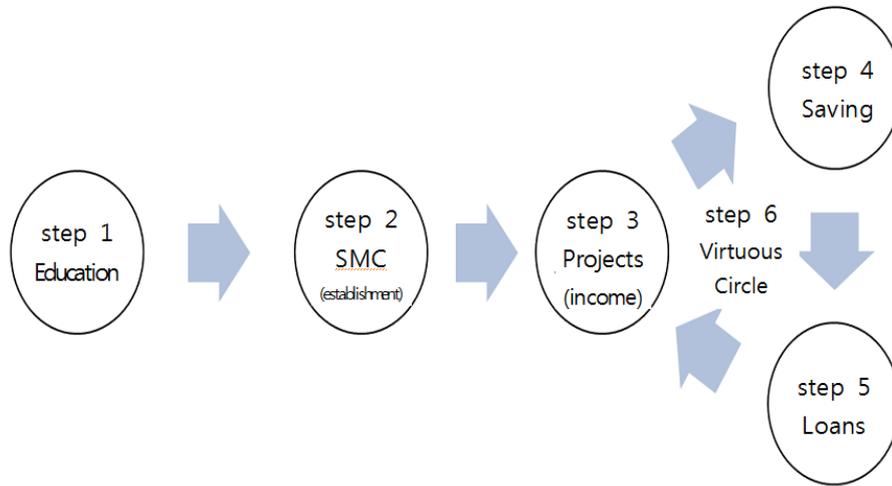
<sup>16</sup> Livestock breeding : pig, chicken, silkworm, cow, etc.

Joint farming : sapling (young tree), forestation, vinyl greenhouse, licorice farming, ginseng farming, etc.

<sup>17</sup> In a large percentage of cases, the village leader became the president of SMC.

<sup>18</sup> Kim, JoonKyung (2013) also emphasized these activities of SMC as the name of Savings Reinvestment Program.

[Figure 4-7] Virtuous Circle of SMC



Source: Sim et al. (2013, 102)

## V. Conclusion & Recommendation

The purpose of this study is to reveal whether the Saemaul Credit Cooperative (SMC) Movement, the Korea's representative microfinance movement, was successful and can serve as a model for development cooperation. To do that, this research evaluated whether there is positive impacts of SMC on income increase or poverty reduction in Korean rural area in 1970s. Through regression analyses, this research showed SMC gave positive effects not only on income increase of the rural people, but also SMU.

After that, this research revealed what features of SMC make difference from other MFIs, especially comparing with Grameen Bank. They are nationwide movement, self-reliant, self-established, and bottom-up movement, saving-oriented movement, micro-credit movement

(with small & credit loans, sound purpose, and low interest rate), education-first movement, and virtuous circle movement through income increase projects.

Such features demonstrate that the SMC is a better MF model than the Grameen Bank, the world renowned MF program, which has been benchmarked by many aid agencies around the world for development cooperation. Therefore, SMC has a good potential to serve as an operational model for future development cooperation programs or projects of Korean aid agencies. Of course, it will have to be adjusted to each developing country based on its own conditions and background.

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