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Can $2,000 loans help revive a war-torn economy? Entrepreneurs in Bosnia and Herzegovina are putting microfinance to the test.

From 1992 to 1995, during war and genocide in the former Yugoslavia, Mejrema Alimanovic made ends meet by working at a kiosk for a Belgrade-based publishing company. The pay was minimal; often she was given food instead of cash. "There were times when we only had enough to survive," says this Bosnian Muslim and divorced mother of two.

Today Alimanovic, 48, is a budding entrepreneur in Lukavac, a town in northeastern Bosnia and Herzegovina. She employs seven people at three food shops and at a stand at the open market, and nets $200 on revenue of $2,800 a month. That puts her on the road toward joining the middle class.

She and her new husband, a war veteran who lost half of one foot to a land mine, bought a Mercedes van and have added a second floor to the home they inherited. Next Alimanovic dreams of buying her own larger store instead of renting space. As shoppers buy from the crates of apples, kiwis, carrots and potatoes that line one store on the ground floor of the apartment complex where she lives, she beams, "We have come a long way."

Alimanovic's transformation to entrepreneur was made possible by microfinance--the lending of small sums to poor people who would otherwise be shut out of access to capital. Since 1998 Alimanovic has taken out ten loans, ranging from $300 for six months to her current three-year, $20,000 loan. Her lender: a nonprofit group called Mi-Bospo, a part of Women's World Banking, a global nonprofit network of 55 Third World lenders and banks. She had no other sources of capital. "I don't think I would have made it this far without Mi-Bospo," says Alimanovic, adding proudly, "I'm one of their best clients."

"Any war-torn country should look to Bosnia as a role model," says Nancy Barry, president of Women's World Banking in New York. When war in the former Yugoslavia ended in November 1995, the economy and its banking system were a shambles. Nearly half the population had been displaced. Gross domestic product fell from $11 billion in 1990 to $2 billion, or $500 per capita, in 1995. To the rescue came a bevy of microfinance groups like Mi-Bospo, many of them aided by funding from the World Bank. Since 1997, 14 nonprofit microlenders have made a combined 350,000 loans worth $750 million in Bosnia and Herzegovina. The default rate is only 1.5%, a third the rate experienced by a typical U.S. credit card lender. Interest rates range from 24% to 31%, reflecting the high-percentage overhead on tiny loans.

The economy of Bosnia and Herzegovina remains shaky--20% of the population live below the poverty line and unemployment is at an estimated 20%. But, since 1996, per capita GDP has tripled to $1,500. "Microcredit groups have had a significant role in Bosnia and Herzegovina in the postwar period, increasing income levels, reducing poverty, developing businesses and stimulating employment," says Kemal Kozaric, governor of the country's central bank.

Microfinance has also helped in war-ravaged Afghanistan. An arm of the government and the World Bank set up a program two years ago that is similar to one in Bosnia. Lacking the alternative of a functioning bank system, 85,000 Afghans have borrowed money or set up savings accounts with 12 microfinance groups. Average loan size is a minuscule $155. The default rate is 1%.

Growth in microlending has been much slower in countries like Angola and Sierra Leone. Efforts have stalled almost completely in Rwanda. Iraq is too unstable for microfinance to flourish. Says Elizabeth Littlefield, chief executive of Washington, D.C.-based microfinance advisory and funding body Consultative Group to Assist the Poor: "You need to have a stable (as opposed to refugee) population, some kind of cash economy, security and economic activity. Without that you can't offer financial services." Or protect employees. Even in Afghanistan, where the armed conflict has ended. The head of the microfinance support program there was killed in early March.

Organized microcredit emerged in the 1970s in places like Bangladesh and Indonesia. Nonprofit lenders learned that poor women, principally because they had children to take care of, are more responsible. Since poor people usually lack a credit history, the first loans were made to groups of women; each woman guaranteed repayment of all the other members of the group. In many countries, including Bosnia and Herzegovina, this type of "solidarity" lending is still common. In this way microlending is reminiscent of the building-and-loan societies of the 19th century, which enabled groups of immigrant families in the U.S. to take turns financing houses for members of the group. There is one important difference: With modern microlending, collateral is usually absent.

Microfinance groups in developing countries have reached at least 80 million clients, helping a growing population of customers and workers (in Bosnia, each loan creates employment for an estimated 1.9 people). That's still only a fraction of a potential global client base of as many as 3 billion people. If there's any criticism of microfinance it's that it's a halfway solution to giving the poor access to capital. Brian Hooks, director of the Global Prosperity Initiative at the Mercatus Center at George Mason University, advocates the kind of legal reform and changes in property rights pioneered by Peruvian economist Hernando de Soto--reforms that will eventually enable the world's poor to join formal financial systems.

Agencies like the World Bank or the U.S. Agency for International Development typically provide seed capital for microlenders. After operating for a few years well-run microfinance groups can become self-sufficient. Mi-Bospo first got $70,000 from the World Bank in 1996, a credit line since extended to a 5%, 15-year term loan of $3.5 million. That loan has in turn enabled it to borrow $2 million from commercial banks; Mi-Bospo has a loan portfolio of $10 million.

In the northeastern Bosnian village of Zivinice, the walls of Edina Bukvic's wedding dress rental shop are festooned with frilly white lace and shiny satin gowns. Bukvic, 35, spent the war years working nights in a restaurant she and her husband own. But she wanted to spend time with her two daughters in the evening. And her childhood dream had been to make wedding dresses like the ones she admired in magazines. Five years ago she opened a rental shop with an initial $900, 6-month loan at 36% interest from Mi-Bospo. Her father-in-law owns the shop and doesn't charge rent; instead she gives her in-laws money every so often.

Bukvic started out making the dresses herself but now finds it easier to buy them. She has 40 to choose from and charges $100 for a rental. The hours are much better than running a restaurant; she doesn't work weekends and usually opens her shop from just 10 a.m. to 2 p.m. "I love what I'm doing," she says. "I have more time for myself and my family now." And more money: Bukvic says she nets about $10,000 a year. The profits have enabled her and her husband to take more weekend trips on their BMW motorcycles to places like Macedonia and the Croatian coastline.

In the future Bukvic envisions an even bigger operation. She wants to turn the restaurant they own into a large dress store with windows. "It would be the only wedding dress shop in the Zivinice region," she says. As a step toward that day, Bukvic is using most of her current $7,000, two-year loan to buy 25 dresses from a shop owner in western Bosnia who is selling out.

Muska Junuzagic has big plans, too. Junuzagic, 46, fled her home in Skelani, a town near Srebrenica in eastern Bosnia, with her four children in May 1992. Her husband was killed, but his body was never found. She and her children lived in Croatia for 18 months and then spent seven years in Germany. Junuzagic made a good living cleaning houses and working in a nursing home but was forced to leave because she was living there illegally. She moved to the town of Srebrenik in northeastern Bosnia and bought a two-room house for $24,000 with her savings. She took out three loans from Mi-Bospo, including her current $2,800, 12-month loan, to buy used clothing that she sells, at a markup of around 100%, out of her house. She wants to expand, by adding a storefront to the side of her house and hiring two young women to make clothes on the two sewing machines she owns. Says Junuzagic, whose education ended partway through high school: "I feel that this is progress. I am moving forward."