

Microfinance and the Illusion of Development: *from Hubris to Nemesis*

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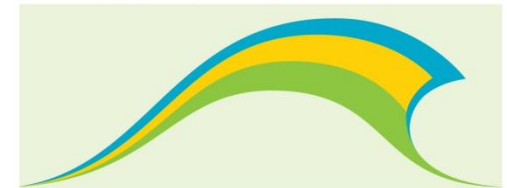


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The humble beginnings

- Muhammad Yunus begins experiments in Jobra village in Bangladesh in early 1970s after returning from USA
- ...he thinks microcredit will lead on to net job and income creation
- ...and also provide foundation for sustainable 'bottom-up' development and growth and gender empowerment
- So key task he sets himself is to provide the rural poor as much microfinance as possible...
- International donors tapped for support (Norway in particular!) and also Bangladesh government

The humble beginnings

- Elsewhere microfinance also gaining ground
- Hernando de Soto in Latin America is big influence with his support for the informal sector
- USAID very active in Bolivia and other states to avoid the poor getting caught up in anti-US movements
- Idea considered so beneficial for the poor that government and donor subsidies are initially tolerated

Hubris

- Yunus claims poverty will be 'eradicated in a generation'
- ...and our children will have to go to a 'poverty museum' to see what all the fuss was about....
- De Soto claims 'heroic entrepreneurs' in microenterprises will power forward poverty reduction in Latin America

The DC folks insist on some changes

- Yes, the neoliberal policymakers in Washington DC love the microfinance concept
-self-help, individualism, no collective action, no trade unions, no state involvement, crucially no call for wealth and power redistribution...
- But, still, in 1980s DC demands a key change – ‘full cost recovery’ is dominant mantra everywhere else, so it **MUST** be introduced into microfinance too
- The poor simply must pay the full cost of the microfinance they receive!!

The DC folks insist on some changes

- World Bank and USAID lead the way in eradicating subsidies from the world of microfinance
- Profits, commercialisation and Wall Street-style incentives will result in a 'free' and massively increased supply of microfinance
- Justification provided by the 'absurd gap' thesis – the demand for microfinance is composed of all those not currently in possession of one – a staggering deception, but it convinces many!
- Even Grameen Bank forced to commercialise or else face becoming irrelevant – change called the 'Grameen II Project'

Hubris

- Commercialisation ‘will provide microcredit to all of the poor’and so will lead to a major historical episode of poverty reduction
- ‘New World of Microfinance’ advocates – Otero, Rhyne, Robinson, et al – claim fantastic poverty reduction gains just around the corner.....
- World Bank (CGAP) and USAID claim ‘major new advance in poverty reduction’

The gathering storm up to 2007

- No evidence of real sustainable transformational impact emerges in the last 30 years... only constant stream of hype, carefully selected anecdotes and PR....
- East Asian 'miracle' economies fantastically productively channel finance into scaled-up enterprises
 - China's TVE movement
 - Taiwan's SME dominated economy
 - Vietnams' super-productive export-oriented family farms
 - lessons clearly learned from European/Third Italy and post-1945 Japanese experience
- Rising informality 'a very serious problem everywhere', according to World Bank....but who is mainly pushing informality? Why, it's the World Bank!

The perfect storm after 2007

- Compartamos in Mexico – huge greed, inefficiency and excess displayed at the time of their IPO
- Even the most optimistic RCTs now coming out show almost zero impact...this is **NOT** what was expected....
- Following Bolivia's 'one-off' 'meltdown' in 1999, we have many more over-supply meltdowns, starting with Nicaragua and Morocco in 2008, then Bosnia in 2009
- Andhra Pradesh's 'meltdown' in 2010 exposes even more greed, fraud and venality than in Compartamos!

Nemesis (1)

- Up to 90% of microfinance is actually used for consumption spending, NOT to fuel income-generating activities
- This means the key dynamic here is one where the poor are getting hooked into **EXPENSIVE** microcredit as a substitute for absent income.....
- This almost inevitably creates Ponzi-style dynamics, whereby the poor begin to access more and more microloans, simply repaying old ones with new ones.....

Nemesis (2)

- Most local economies for many years have been 'saturated' with just the sort of simple outputs and services typically produced by informal microenterprises
- See brilliant work of Jan Breman (2003) on India, and Mike Davis (2006) on the global slum phenomenon
- Leads to high levels of displacement and failure
- Yunus famously helped one individual - a basket-maker - do better with a microloan, and went on to assume that ALL in the village could likewise do better.....BUT WHERE IS THE LOCAL DEMAND???
- In other words, **Yunus completely misunderstood (or chose to mislead others...?) as to the importance of the 'fallacy of composition'**

Nemesis (3)

- Microfinance destroys social capital/solidarity in a big way
- Microfinance since 1990s is now a 'business', so quite predictably we have:
 - Aggressive loan collection techniques –
 - The 'microfinance millionaire' phenomenon
 - Shift into more profitable consumer loans – gets the poor addicted to expensive credit and Ponzi-style dynamics
 - MF managers increasingly lobby to obtain the 'freedom' to loot their own MFI

Nemesis (4)

- Poverty reduction and sustainable development are simply **NOT** in the gift of informal microenterprises and self-employment
- Africa has the highest number of microenterprises and individual entrepreneurs in the world.....
- Africa's problem is that it has far too **MANY** microenterprises absorbing its scarce financial resources, while the needs of more productive SMEs – the 'missing middle' – are by-passed!
- This is why leading development economist Ha-Joon Chang (2011) concludes **microfinance is actually a poverty trap, especially in Africa**

Nemesis (4) continued

- Inter-American Development Bank (IDB) fully agrees for Latin America –
- IDB's central conclusion is explosive - "Unlike other regions of the world, the overwhelming presence of small companies and self-employed workers (in Latin America) is a sign of *failure*, not of *success*"
- In Bosnia, the proliferation of informal microenterprises and self-employment is termed 'Africanisation' (*Africanizacija*) – now widely recognised that microfinance has undermined the recovery of the country

But if microfinance is so bad, then why is it supported so much?

- Put simply, because neoliberal policy-making elite (World Bank, IMF, USAID) and market fundamentalists love it!
 - Self-help, poor work their own way out of poverty – a few succeed and you can praise them, most fail but you can then blame them for their poverty! (they were too lazy, they made wrong asset portfolio choices, etc)
 - Delegitimizes all forms of collective action – poor pushed to abandon goals of an active developmental state, trade unions, social pressure groups, collective effort, etc
 - Governments use microfinance to facilitate cuts in public spending on the poor and women, left with only microfinance to use to access expensive services from the private sector
 - Fiscal austerity – the poor don't need welfare anymore, just microfinance, so we can cut taxes on the rich!
- Plus, the edifice of microfinance supports many lucrative careers, programs and institutions – logical that supporters want it to continue no matter what!

Alternatives to microfinance

- For simple consumption spending, the poor need credit unions – which are not-for-profit, community-managed financial units that offer low cost loans
- For small enterprise financing, the poor do way the best with local banks, financial cooperatives and community development banks
- The poor are also far better off with micro-saving rather than microdebt (e.g., Oxfam's new projects)
- The poor can also be helped much better with CCTs and cash grants, which allow them to avoid microenterprises!

Conclusion

- Those behind microfinance may have started with good intentions, **but it was a fundamentally flawed idea**
- Commercialisation then completely destroyed the concept, but paradoxically served to keep the idea afloat because some people could make huge private gains and it was now 'free' to governments
- Neoliberal ideology was critical in first establishing and then keeping it going - self-help and individual entrepreneurship are totemic!
- Today microfinance increasingly accepted as 'anti-development'
- The main development agencies now moving on to look at the 'missing middle' problem, meaning SME banks and so on
- And also dealing with poverty through cash grant programs that are working very well everywhere

Thanks for listening

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