‘Why Doesn’t Microfinance Work?
The Destructive Rise of Local Neoliberalism’

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The birth of Microfinance [MF] in late 1970s Bangladesh…

- Long history of small-scale credit in India, Pakistan and then Bangladesh – Akhtar Hameed Khan’s ‘Comilla model’
- In late 1970s Dr Muhammad Yunus sees microcredit examples and develops his own model - pitches it to the donor community
- Grameen Bank formally established in 1983 to lend to the poor for income-generating activities (IGAs)
- ‘*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*…’
- International donors love the non-state, self-help, fiscally responsible, and individual entrepreneurship angles
- Supposedly high repayment rates in Grameen Bank (much exaggeration later found) mean the poor seen as ‘bankable’

Washington DC institutions insist on a few changes…

- In 1980s policymakers in World Bank and US government pushing the mantra of ‘full cost recovery’
- Hard-line belief is that the poor must pay the FULL costs of any program ostensibly designed to help them
- MF to be no exception….MF is neoliberalised...
- CGAP and USAID appointed to take lead in imposing the ‘New Wave’ MF model that replaces the Grameen Bank as ‘preferred practise’
- Key methodology to impose high interest rates and Wall Street-style rewards (high salaries, bonuses, share options) which should lead to maximum efficiency

But by late 2000’s MF begins to run into a host of problems

- By early 2000s MF increasingly becomes clear that MF ‘all talk and no walk’ - poverty not actually seen to be reduced anywhere

- More scope to critically analyse what accomplishments have really been made.....

- Paradigm shift underway it seems....

Why basic Grameen Bank-syle MF is bad? (I)

- Economies of scale ignored
  - Minimum efficient scale ignored – one result is that client failure endemic (in Bosnia, WB finds 50% fail in any one year – in 50 communities study across Tamil Nadu, found that 99% of borrowers fail after 3 years, most plunge into deeper poverty)
  - Subsistence farms enticed into MF get into huge difficulties, just not productive enough to cover 35-40% interest rates – in India, especially in MF ‘saturated’ Andhra Pradesh rural poverty has actually risen in last two decades, not fallen
  - Dichter’s Microcredit paradox – ‘*the poorest people can do little productive with credit, and the one’s who can do the most with it are those who don’t really need microcredit, but need larger amounts and longer credit terms’*

Why basic Grameen Bank-style MF is bad? (II)

- Yunus misunderstood the ‘Fallacy of composition’ – he falsely drew a conclusion from one case that all local economy will benefit if this case scaled-up…!

- Most local markets in poor countries for many years saturated with the simple products and services consumed locally and produced in microenterprises

- So, adding to local capacity to supply such simple products and services generally means:
  - 1. Local prices fall – clients and non-clients suffer
  - 2. Turnover falls, margins, profits and wages too

Why basic Grameen Bank-style MF is bad? (III)

- Deindustrialisation and infantilisation
  - Programmed Morgenthau Plan-style infantilisation and deindustrialiation of local economy
  - ‘Africanisation’ – the programmed return to a 19th century-style dependence upon the simplest non-industrial, petty trade-based microenterprises
  - Africa increasingly trapped as a bazaar economy (Dambisa Moyo was ‘dead wrong’ to support MF as a solution…)
  - Microenterprises not really suitable to connect local enterprise system either horizontally (clusters, networks) or vertically (subcontracting, commodity chains)

Why basic Grameen bank-style MF is bad? (IV)

MF impacts agriculture sector particularly badly…

- MF not suitable for minimum efficient scale farms, and key associated investments (quality seeds, fertilizer, irrigation, storage, etc)

- Yet ‘Postage stamp’ farms bowled over by offers of MF simply cannot achieve efficiency - leads instead to Andhra Pradesh-style agricultural inefficiency and ultimately to a ‘microdebt crisis’

- Family farms and agricultural coops urgently need support, but don’t get it (opportunity cost argument)

Why basic Grameen Bank-style MF is bad? (V)

- MF extends informality
  - Extends and legitimises bad business practises, illegality, tax avoidance, crime
  - Undermines growth of the formal sector through ‘race to the bottom’ and taking market share ‘unfairly’
  - So Hernando de Soto quite wrong in predicting informal microenterprises could be the ‘heroic entrepreneur’ catalysts behind rapid and sustainable development and poverty reduction

Why basic Grameen Bank-style MF is bad? (V)

- MF destroys social capital/solidarity
  - solidarity used up/destroyed as repayment prioritised over development (no technical support provided, threats used, assets seized, etc)
  - Governments use MF to cut public spending on the poor and women, left with only MF to use to access expensive services from the private sector
  - MF > informality > violence > destroys solidarity (Mike Davis ‘Planet of Slums’)

And then MF is neoliberalised - the final nail in the coffin of MF

- Push for financial sustainability at all costs – poverty reduction objectives now reduced to a PR function – the poor simply must be made to pay the **full** costs of MF supply!

- Interest rates high everywhere – Mexico up to 80%, Bangladesh 30-40%, Bolivia 30-40%....almost no **real** businesses can service such rates, only petty trade and services **– but this is not building a foundation for growth**

- One common justification for high R/I is that 'running costs are high' – but often (as in Compartamos, SKS) this is costs of Wall Street-style management salaries and bonuses..!

- Another justification for his interest rates is that it allows for more microfinance elsewhere – the poor are being made to pay to help others also in deep poverty – hardly the most fair and equitable solution to poverty!

- Finally, no historical experience to show that under high interest rate regime, the poor can escape poverty – western European and East Asian 'tiger' local economic success was built upon low cost capital, subsidies, policy-based lending and other heterodox interventions!

And I'm annoyed I missed out on three important recent issues.....

- The forthcoming IPO of SKS in India – looks likely that it will magnificently top the Compartamos episode in terms of exposing sheer greed, profiteering, inefficiency and vulgarity....Mr Vikram Akula has already netted $12 mn from the sale of just 25% of the share options he generously awarded himself – a great example of social anthropologist David Harvey calls 'accumulation by dispossession'..............

- IADB flagship 2010 report '**<u>The Age of Productivity: Transforming Economies from the Bottom-Up</u>**' says that Latin America's poor growth and high poverty a result of 'too many self-employed and microenterprises, and not enough focus on SMEs....' microenterprises have no productivity-growth potential. Further evidence for the 'Iron Law of Microfinance' – the more MF you have, the more you will remain trapped in poverty'

- Malawi – went from basket case to bread-basket in 3 years thanks to careful $50mn program of subsidisation of inputs (fertilizer and seeds) – these inputs could have been easily microcredit before, <u>but few farmers chose to do this because the high interest rates would have made the farm</u> unprofitable, which risked losing the farm if/when loan defaulted on**.**

So if MF doesn't actually work, why then so much international donor community support for MF?

- Grameen's emphasis upon self-help, individual entrepreneurship and fiscal responsibility was **JUST** what the international donors were looking for in the 1980s as neoliberal project getting underway

- All forms of state intervention, collective effort, social mobilisation and wealth/power redistribution now rendered inoperative – individual (petty) entrepreneurship now the **ONLY** route out of poverty for the poor! – business and political elites everywhere breathe a big sigh of relief....

- The subsequent neoliberalisation (commercialisation) of MF then very neatly justifies ending all forms of financial support for the poor – the poor can and should be made to pay for their own (supposed) way out of poverty!

- 'women's access to the market (is) the primary route for their empowerment' (Naila Kabeer) – this is the key to explaining MF - it is **MARKETS** which are being empowered here, **NOT WOMEN**

It also helps that impact evaluations deliberately inflate the impact

- Impact evaluations studiously ignore:
  - Job displacement – generally no net employment or income gains – Yunus and others fundamentally err by misunderstanding/ignoring the ‘fallacy of composition’
  - Client failure – most microenterprises fail and hapless individuals fall into deeper poverty – no-one interested in this – most survey look at young microenterprises and build results on this

Conclusion

- MF is a major misdirection of scarce funds (savings, remittances, donor/government funds) and time – that is, huge opportunity cost!
- Evidence shows that MF ultimately destroys sustainable local economic and social development trajectories – it <u>**‘institutionalises poverty and under-development’**</u>
- Lesson from previous economic success in the west and East Asia simply ignored – another example of ‘kicking away the ladder’ (Ha-Joon Chang)
- Commercialisation final nail in the coffin – institutional survival and private greed, <u>not sustainable local development</u>, now becoming the main goals (Wall Street redux)
- MF disempowers the poor by deliberately restricting their ability to use their <u>**‘collective capabilities’**</u> to effect real pro-poor change
- <u>One final thought</u> - Jobra village in Bangladesh where Grameen bank was born STILL trapped in deep poverty and deprivation, and since the 1990s now enmeshed in serious debt problem….