

Microfinance and the Illusion of Development: from Hubris to Nemesis in Thirty Years

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Abstract – The contemporary model of microfinance has its roots in a small local experiment in Bangladesh in the early 1970s undertaken by Dr Muhammad Yunus, the US-educated Bangladeshi economist and future 2006 Nobel Peace Prize co-recipient. Yunus’s idea of supporting tiny informal microenterprises and self-employment as the solution to widespread poverty rapidly caught on, and by the 1990s the concept of microfinance was the international development community’s highest-profile and most generously funded poverty reduction policy. Neoclassical economic theorists and neoliberal policy-makers both fully concurred with the microfinance model’s celebration of self-help and the individual entrepreneur, and its implicit antipathy to any form of state intervention. The immense feel-good appeal of microfinance is essentially based on the widespread assumption that simply ‘reaching the poor’ with a tiny microcredit will automatically establish a sustainable economic and social development trajectory, a trajectory animated by the poor themselves acting as micro-entrepreneurs getting involving in tiny income-generating activities. We reject this view, however. We argue that while the microfinance model may well generate some narrow positive short run outcomes for a few lucky individuals, these positive outcomes are very limited in number and anyway swamped by much wider longer run downsides and opportunity costs at the community and national level. Our view is that microfinance actually constitutes a powerful institutional and political barrier to sustainable economic and social development, and so also to poverty reduction. While an unfashionably novel argument to make until very recently, recent research by mainstream bodies is now beginning to come around to the possibility we raise here, and earlier (see Bateman, 2003, 2010, 2011a; Bateman and Chang, 2009; Chang, 2011), that the programmed outcome of the microfinance model – informal microenterprises and self-employment – is indicative of a seriously damaging trajectory into the longer term (a recent high-profile publication confirming our view is IDB, 2010). Moreover, our argument is strengthened by recent well-publicised problems pertaining to the microfinance model, particularly the catastrophic sub-prime-style over-supply situations that have developed in Bosnia and Andhra Pradesh state in India, both of which attest to the fundamental flaws in the microfinance model that we highlight in this article. Finally, we suggest that continued support for microfinance in international development policy circles cannot be divorced from its supreme serviceability to the neoliberal/globalisation agenda.

Key words: microfinance, microcredit, neoliberalism, impact, poverty, development.

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1. Introduction³

As originally conceived, microfinance (more accurately, microcredit⁴) involves the provision of a small loan, a microloan, that is used by a poor individual to support a tiny income-generating activity, thereby to generate an income sufficient to effect an exit from poverty. Since the early 1980s, the microfinance-supported proliferation of informal microenterprises and self-employment has been very widely promoted as the solution to poverty and under-development. By the 1990s, microfinance was the international development community's highest-profile and most generously funded poverty reduction policy (for example, see Balkenhol, 2007; 213). The expectation began to form that an historically unparalleled poverty reduction and 'bottom-up' economic and social development episode was in the making.

This article challenges the view that the microfinance model has a positive association with sustainable poverty reduction and local economic and social development. On the contrary, we find the microfinance model is likely to lock people in a 'poverty trap'. Moreover, in a growing number of 'microfinance-saturated' countries, regions and localities, the outcome of the microfinance model has been nothing short of catastrophic. Nonetheless, despite the growing evidence that it has failed in its original mission, a fact that even long-standing proponents now concede, the microfinance model still largely retains its reputation and popularity within the international development community as a policy instrument that can efficiently resolve poverty and under-development. To help explain why there is such a widespread misunderstanding of microfinance, we go on to argue that the microfinance model remains attractive to the international development community because of its huge political serviceability to the neoliberal worldview that centrally locates the main driver of economic development to be individual entrepreneurship.

The article is structured as follows. Section 2 briefly charts the rapid rise of the microfinance model after 1980 and its recent tribulations since mid-2007 that have contributed to people waking up to a completely new understanding as to its long-term impact. Section 3 then summarises the key areas where we feel the theory behind microfinance as opposed to its mere (possibly inefficient) execution, has proved to be

³ This article is a substantially revised and updated version of a 2009 mimeo (Bateman and Chang, 2009).

most problematic. Section 4 explores the intimate links between the neoliberal globalisation project and the microfinance project. A brief conclusion summarises the argument.

2. Background

Microfinance has a long history and encompasses a diverse range of institutional formats, ranging from individual money-lenders through to more formal institutions, such as village banks, credit unions, friendly societies, financial cooperatives, building societies, state-owned banks for SMEs (Small and Medium-sized Enterprises), social venture capitals funds, and specialised SME funds. Probably the majority of these local financial initiatives, especially those from the 18th and 19th century onwards, arose from a desire to transform the lives of the poor and the new industrial working classes as they struggled to cope with the growing perils and exploitation associated with the rise of industrial capitalism. Noteworthy examples include the many Friendly Societies that were an outgrowth of the rapidly growing trade union movement (Thompson, 1963) and the financial institutions established by the burgeoning Europe-wide cooperative movement that began in England and Scotland in the early 1800s (Birchall, 1997). In short, the objective was not so much to help the poor to passively accept their poverty and exploitation under elite-dominated economic systems, but to genuinely empower the poor by enlarging the space of economic and social activity under their effective (and proto-democratic) ownership and control.

The recent explosion of interest in microfinance represents something quite different, however. At the forefront of this new microfinance movement was Dr Muhammad Yunus, the Bangladeshi born and US educated economist. Following a number of experiments in the mid-1970s with the provision of microcredit in and around the village of Jobra near Chittagong in Bangladesh, Yunus began to argue that the mere availability of a microloan would greatly benefit the poor everywhere, and especially women in poverty. The poor simply had to establish and operate an informal microenterprise in their local community and they would be well on the way to escaping their poverty. Yunus took to claiming that microfinance would ‘eradicate poverty in a generation’ and

⁴ The term ‘microfinance’ is the most commonly used term today, so we use this term. Microfinance is actually the generic term covering all varieties of microfinancial interventions, such as microcredit, microsavings, microinsurance, micro-franchising, and so on.

he confidently predicted that very soon our children would have to go to a ‘poverty museum’ to find out what all the fuss was about (for example, see Yunus, 1997).

The international donor community very much liked what Yunus was saying, and so agreed to underwrite his bold ideas for promoting self-help and individual entrepreneurship among Bangladesh’s poor through a dedicated institution – the Grameen Bank. The Grameen Bank was formed in 1983 and, largely based on Yunus’s constant declarations that it was an enormous success, it was pretty soon being copied all over Bangladesh and then all over the world. A new efficient model of poverty reduction and ‘bottom-up’ development appeared to have been found.

However, although neoliberal policymakers greatly appreciated the emphasis upon self-help and individual entrepreneurship, they still had major reservations about the financing of the Grameen Bank microfinance model. This was because it soon became clear that Grameen Bank’s operations, as with most MFIs that had sprung up around the world at that time, actually depended upon a continuous inflow of subsidized capital. This funding was mostly provided by an MFI’s own government and/or by the international development community. The neoliberal policymaking community began to feel increasingly awkward about the extensive use of government and donor subsidies to keep the supposedly non-state, market-driven microfinance sector going. Spearheaded by the main Washington DC institutions – USAID and the World Bank - decisive action was therefore initiated to phase out the original Grameen Bank model of subsidised microfinance. The long-term solution to the ‘problem’ of subsidies in the microfinance sector was found in the idea to reconstitute microfinance as a private for-profit unsubsidised business model. Key advocates of commercialisation (notably Otero and Rhyne, 1994; Robinson, 2001) saw this new model, and the likely increase in the supply of microfinance, as being capable of generating huge benefits for the poor.

By the early 1990s a thoroughly ‘neoliberalized’ for-profit model of microfinance was being ushered in as the ‘best practise’ replacement for the original subsidized Grameen Bank model. This ‘new wave’ model (formally known as the ‘financial systems’ approach – see Robinson, 2001) quickly became the official definition of microfinance. By the turn of the new millennium, the ‘new wave’ microfinance model was at the peak of its power and influence. Even the iconic Grameen Bank felt it had no other option but to agree to convert over to ‘new wave’ respectability, which it did in 2002 with the ‘Grameen II’ project. The UN declared 2005 to be the International Year of Microcredit. Numerous prestigious awards were also forthcoming for those involved in microfinance,

famously including the 2006 Nobel Peace Prize going to Muhammad Yunus and his Grameen Bank. And thanks to all this activity, the list of ‘microfinance-saturated’ countries (defined in terms of borrowers per capita) soon began to comprise not just the original pioneer Bangladesh, but also Bolivia, Bosnia, Mongolia, Cambodia, Nicaragua, Sri Lanka, Peru, Colombia, Mexico and India (see Bateman, 2011b, 4, Table 1.1). It seemed obvious to all involved that the world was undergoing an historically unparalleled episode of poverty reduction. But then the carefully constructed edifice of modern microfinance began to collapse.

Beginning in 2007, and in a most rapid, dramatic and unexpected fashion, hubris was followed by nemesis. It is widely recognised that the first spark was provided by the 2007 IPO of the Mexican MFI, Compartamos. Rather than revealing commendable levels of poverty reduction among poor Mexican individuals – there still remains no evidence for this whatsoever - the IPO process revealed instead the Wall Street-style levels of private enrichment enjoyed by Compartamos’s senior managers. These vast rewards were effectively made possible by quietly charging 195% interest rates on the microloans taken out by their poor mainly female clients.⁵ The Compartamos IPO led to much public outrage against Compartamos, and then a tidal wave of criticism of the commercialised microfinance model in general. Even long-standing supporters of microfinance began to openly express their concerns at the way the microfinance concept was being destroyed in the hands of neoliberals and hard-nosed investors (notably Malcolm Harper – see Harper, 2011: see also Klas, 2011; ‘Anonymous’, 2012).

Very soon the narrow criticism of the Compartamos IPO and commercialised microfinance was joined by a much wider critique of microfinance as a ‘bottom-up’ development model *per se* (see Dichter and Harper, 2007; Bateman and Chang, 2009; Bateman, 2010, 2011a). Other researchers using new and supposedly more accurate Randomised Control Trial (RCT) methodologies found little to no impact arising from microfinance (Banerjee *et al*, 2009; Karlan and Zinman, 2009). Roodman and Morduch (2009), joined by Duvendack and Palmer-Jones (2011), mounted a serious challenge to the single most important piece of evidence routinely cited as the best evidence that microfinance had a strong poverty reduction impact – a study undertaken in the 1990s by then World Bank economists Mark Pitt and Shahidur Khandker (Pitt and Khandker,

⁵ See http://blogs.cgdev.org/open_book/2011/01/compartamos-and-the-meaning-of-interest-rates.php

1998). Both sets of authors examined the original dataset used by Pitt and Khandker and could find no evidence to confirm a positive impact from microfinance.⁶

Also adding considerable impetus to the growing critique of the microfinance model were a number of hugely destructive sub-prime-style ‘microfinance meltdowns’ taking place around the globe. The first ‘microfinance meltdown’ had actually taken place in Bolivia in 1999-2000, but at the time microfinance supporters described it as a ‘one-off’ aberration caused by factors supposedly unrelated to the core of the microfinance model, such as unfair competition from a large MFI coming to Bolivia from Chile (see Rhyne, 2001). However, starting in 2008, a new round of even more destructive ‘microfinance meltdowns’ began in Morocco, Nicaragua and Pakistan, marked out by huge client overindebtedness, rapidly growing client defaults, massive client withdrawal, and the key MFIs plunging into loss or forced to close or merge. These episodes were then quickly followed in 2009 by the dramatic near-collapse of the hugely over-blown microfinance sector in Bosnia (see Bateman, Sinković and Škare, 2012). By all accounts, the most devastating ‘microfinance meltdown’ to date started in late 2010 in the Indian state of Andhra Pradesh (Arunachalam, 2011). With the poor increasingly taking out more and more microloans in order to repay some of the earlier microloans they had all too easily accessed, it was clear that the microfinance model in Andhra Pradesh had degenerated into nothing more than a vast Ponzi-like survival strategy for a very large number of the poor.⁷ In late 2010, thanks to a deluge of personal over-indebtedness, defaults and MFI losses, Andhra Pradesh’s microfinance industry effectively collapsed.⁸ Further over-supply problems are also clearly emerging elsewhere, notably in Mexico, Peru, Azerbaijan and Kyrgyzstan.⁹

In 2011 came a further serious blow for the microfinance industry. This was a UK government-funded systematic review of virtually all of the impact evaluation evidence

⁶ Notably, as Roodman and Morduch discussed in their revised paper published in 2011, Pitt and Khandker did not examine and rule out reverse causation, meaning that their reporting of a positive association between microcredit and household spending may simply indicate – as is the case in very many countries - that richer families borrow more.

⁷ By late 2009 it was found that poor households in Andhra Pradesh were on average in possession of a total of 9.3 microloans, compared to between 2 to 4 microloans per poor household in the next most saturated states in India - Tamil Nadu, Orissa, Karnataka and West Bengal (see Srinivasan, 2010)

⁸ In mid-2010 the microfinance industry possessed a gross loan portfolio of nearly \$3 billion (up from just \$230 million in 2006), but it is predicted that it will almost entirely cease to exist by early 2012. For example, with its once nearly £1 billion microloan portfolio in Andhra Pradesh almost entirely written off by the end of 2011, the largest MFI in the state – SKS - has announced it will move into new areas of operation as of early 2012, including rural insurance, rural payments and small business lending. http://www.dnaindia.com/money/report_new-sks-head-talks-of-sea-change-in-business-model_1617016

long said to confirm that microfinance has had a positive impact on the well-being of the poor (Duvendack *et al*, 2011). Most importantly, the review found that the previous impact studies were almost all seriously biased, incomplete or else very poorly designed to the point of being quite unusable. The Duvendack review reached an explosive conclusion, arguing that ‘(the) current enthusiasm (for microfinance) is built on (..) foundations of sand’ (page 75). Importantly (especially in the context of our comments below), the very final comment (page 76) points to the case for microcredit having been made not so much on the basis of the *economics* (of poverty reduction and development), but to the *politics*, and the authors conclude that further research is required by political scientists in order to understand ‘(why) inappropriate optimism towards microfinance became so widespread’.

We agree with the substance and direction of much of the growing criticism of microfinance. However, our own scepticism on this issue is not just rooted in our analysis of the fundamental economic principles upon which the microfinance concept is based, as we will outline in the next section, but also in the important counterfactual that emerges from a careful examination of the economic history of the most successful national, regional and local economies. For if one looks at the advanced economies (USA, Japan, Western Europe), as well as of the East Asian ‘tiger’ economies that burst on to the scene from the 1970s onwards (South Korea, Taiwan, Malaysia, China, Thailand and, most recently, Vietnam), one finds evidence of a successful national economic model that is almost the exact opposite of the market-driven microfinance model. As is now widely accepted (see Amsden, 2001, 2007; Chang, 2002, 2006, 2007, 2011; Reinert, 2007; Wade, 1990), sustainable progress was forthcoming in all these countries largely thanks to a range of pro-active ‘developmental state’ interventions. In addition, a pivotal element underpinning the success achieved in many of these ‘developmental state’ countries also lies in what has been termed the ‘local developmental state’ (LDS) model - pro-active local development and growth strategies undertaken by local government level institutions (see Friedman, 1988; Weiss, 1988; Oi, 1995; Lall, 1996; Bateman, 2000; Thun, 2006). This successful LDS model is very far removed indeed from the microfinance model, even though it may have some superficial similarities to it (for examples, see Bateman, 2010, Chapter 7).

⁹ Private communications with MFI analysts: see also CGAP, 2010

3. Why microfinance most often makes things worse, if not much worse

The above section has demonstrated that, after a seemingly auspicious beginning, in recent years the microfinance model has clearly run into a brick wall. In this section we identify the key factors that account for why it is that the microfinance model has had such an adverse impact at both the local community level and national economy level.

(a) *The microfinance model ignores the crucial role of scale economies*

By definition, *microfinance* produces *microenterprises* – that is, enterprises and agricultural units that are very small and probably cannot operate at minimum efficient scale. However, it is widely accepted that for all enterprise sectors there remains an identifiable minimum efficient scale of production, and operating below this level makes it virtually impossible for any enterprise to survive and prosper in a competitive business environment.

In general, we may say that microfinance policymakers largely fail to register the crucial importance of minimum efficient scale. What matters above all, so their argument runs, is to construct a local financial system dominated by MFIs that can establish as many microenterprises as possible in the short term. Going further, microfinance supporters actually argue that a foundation of the tiniest microenterprises is actually a sufficient foundation for sustainable development. As Dambisa Moyo (2009; 129) relates of her native Zambia, ‘Think of a woman selling tomatoes on a side street. (.) this group – the real entrepreneurs, *the backbone of Zambia’s economic future* – need capital just as much as the mining company’ (italics added). The argument here is essentially that scale does not matter, and that many more of such tiny microenterprises will indeed provide the best possible foundation for development. It is an argument that has been extensively taken up by the microfinance industry as a whole: it is the *numbers* of microenterprises established that appear to matter the most, rather than their (initial) *size*. But is it an argument that holds water?

Consider the situation in India. Despite its rapid growth in recent years, India still has many development and poverty-related problems. One of the most pressing of its development problems is the need to fill the so-called ‘missing middle’ that exists between, on the one hand, the small number of large internationally well-known computing and manufacturing companies and, on the other hand, the hundreds of

millions of ‘survivalist’ informal microenterprises. Put simply, India has so far failed to nurture an innovative and growth-oriented SME sector - one that would be capable not just of providing millions of desperately sought-after formal sector jobs, but also of acting as an efficient subcontracting and supplier base for the large firm sector. Meanwhile, the microfinance sector in India has been growing very rapidly indeed, especially in Andhra Pradesh state, as we noted above. As of 2006 microfinance constituted 15% of all commercial bank lending in the whole of India, while, as Arunachalam (2011) extensively documents, the non-bank microfinance sector has experienced a significant boom this last decade thanks to the entry of private entrepreneurs and other financial institutions and foreign investors. Crucially, the growth of funding for microfinance has partly arrived thanks to the diversion of funds away from other uses, particularly financial support for SMEs. This substitution effect is one of the main features of the Indian banking sector this last decade, and at least partly driven forward by the Indian government’s firm belief in the virtues of microfinance (commercial banks in India are required by law to allocate a certain percentage of their funds into the microfinance sector, usually via MFIs)

As Karnani (2007) points out, however, the growing focus on microfinance and microenterprises in India, and the concomitant reduction in funding and support for SMEs, has quite dramatically *undermined* the productivity and overall efficiency of India’s economy (see also Karnani, 2011).¹⁰ This is because the SME sector has seen what little hope it had of obtaining financial support recede even further into the distance. Providing finance to the SME sector is both risky and low margin work for India’s banks, compared to both investing in its large Indian and foreign companies, which is a secure and stable investment, and investing into India booming microfinance sector, which (until recently) demonstrated high returns. Karnani’s (2007; 39) conclusion is that millions of survivalist microenterprises cannot be a firm foundation for India’s growth and poverty reduction efforts, noting that ‘The average firm size in India is less than one-tenth the size of comparable firms in other emerging economies. The emphasis on microcredit and the creation of microenterprises will only make this problem worse’.

In neighboring Bangladesh - the spiritual home of modern microfinance – the situation in this respect is probably even worse than in India. With a high and growing share of the country’s savings and commercial funds being recycled into highly

¹⁰ See also ‘Microcredit: why India is failing’, *Forbes*, 10 November 2006.

profitable microloans, and with officially the highest microfinance penetration rate in the world (25% of the population are borrowers from MFIs – see Bateman, 2011b, 4), the SME sector has effectively been displaced and starved of funding.

Interestingly, some of the international development agencies are, finally, beginning to recognize the potential damage here, and that the far more productive SME sector is increasingly being left to wither on the vine. For example, research by the UK government's DFID aid arm summarized the situation in Bangladesh today (see DFID, 2008: 2-3), as one where,

The financial system - including banks, capital markets and the micro-finance sector - is inadequate to support long term investment financing for growth. Smaller firms, responsible for the lion's share of employment, have severely limited access to financial resources. *Rural areas, with the highest potential for lifting low income groups out of poverty, are cut off from most financing mechanisms.* (Our italics)

If 'smaller firms' are finding it difficult to access financial support in the rural areas of Bangladesh, areas where the country's famed MFIs are increasingly in a desperate search for new microenterprise clients, then the 'smaller firm' funding situation is clearly very bad indeed. However, there is very little that the Bangladesh government appears capable of doing to change things, and to stop the hugely unproductive informal sector from absorbing such a large part of the scarce funds available in that country (mainly savings and its vast remittance flow). In other words, just like in neighboring India, the massive microfinance industry in Bangladesh is a major *obstacle* in terms of supporting the formal sector enterprises operating at or above minimum efficient scale that the country very urgently needs in order to sustainably develop and reduce poverty.

The very same deleterious scenario is a major problem in Latin America too, as the IDB (2010) strongly emphasises. In Mexico, for example, the manifest shift of resources into the hugely profitable microfinance sector has directly precipitated a booming sector of 'changarros' (informal microenterprises, or simply 'mom and pop stores'), but at the same time it has undermined the desperately required capitalization and expansion of Mexico's crucial SME sector. One result, as Levy (2007) argues, is that, 'There are more resources to subsidize informal employment than formal employment' and so 'Mexico is probably saving less and investing in less efficient projects'. Mexico's biggest

development problem today has become one of ‘Over-employment and over-investment in small informal firms that under-exploit advantages of size, (and so) invest little in technology adoption and worker training’.

However, perhaps the most dangerous ‘primitivising’ aspect of microfinance here is in relation to the agricultural sector, and against a background of food shortages and agricultural commodity prices rises that are (re)introducing food insecurity problems in many developing countries. It is well known that the microfinance sector has proved adept all around the globe at moving into the subsistence farming sector. Yet there is a wealth of evidence to show that tiny agricultural units supported by microfinance are simply *not* the most appropriate agricultural units to be supported if a developing country wants to achieve sustainable rural jobs growth and local food security. Nor are the sort of large-scale plantation-style farms advocated by commentators such as Collier (2008) any better for the local community, not least since they employ few people on decent wages, may destroy the local ecology, and the often large profits go up to a tiny elite (which is often not even resident in the country concerned).

Commercially-oriented small family farms are in many circumstances the most valuable in terms of contributing to sustainable and equitable agricultural sector development. This is because family farms help to maximize the potential to adopt technologies and practices that create rural employment opportunities, raise agricultural productivity, re-localize the consumption of food, address food security issues, and all without damaging nature’s goods and services (see Norberg-Hodge, Merrifield and Gorelick, 2002; Pretty, 2005). Notwithstanding, the microfinance sector today continues to recycle a country’s valuable financial resources into the tiniest of subsistence farms, which are the *least* efficient forms of farming, while ignoring the farming units and structures of *most long-term* benefit to the local community overall. It is difficult to conceive of a more damaging local financial structure in terms of facilitating the programmed long-term destruction of the agricultural sector.

An obvious illustration of the structural damage to agriculture brought about thanks to microfinance is in the Indian state of Andhra Pradesh, as noted above, a global pioneer in increasing the supply of microfinance. By all accounts, from the 1990s onwards the profit-driven channelling of large quantities of microfinance towards tiny subsistence farming units has precipitated a human and economic disaster. With evidence of a growing over-indebtedness to a new breed of commercial MFI, offering immediate access to a microloan but at a deceptively high interest, the Andhra Pradesh rural

economy began to implode. The state authorities commissioned a major report to look into the problems (see Commission on Farmers Welfare, 2004). The report centrally noted that ‘Agriculture in Andhra Pradesh is in an advanced stage of crisis (.). The heavy burden of debt is perhaps the most acute proximate cause of agrarian distress. The decline of the share of institutional credit, and the lack of access to timely and adequate formal credit, in the state have been a big blow to farmers, particularly small and marginal farmers.’ (*ibid*: i). Notwithstanding these findings, nothing was done to stop rural over-indebtedness to the new highly commercial MFIs rising even *more* dramatically than before.¹¹ A serious microcredit bubble was created, which in 2006 collapsed in the shape of the ‘Krishna Crisis’ (Arunachalam, 2011).

The core problem here was that the *least* productive subsistence farms were all too easily able to access a microloan, when it should have been clear that they could really do almost nothing with it. Any marginal increase in output was simply not enough to cover the high interest rate charges on the microloan that gave rise to it. Of course, many subsistence farmers were desperate and so it was easy for the local MFIs to persuade those already in debt to accept more of virtually *any* form of credit at *any* rate of interest in order to try vainly to resolve their long-standing problems. But the result of the subsistence farming community accessing microfinance in Andhra Pradesh was the gradual entrapment of several hundreds of thousands of its tiniest and least productive subsistence farms in a vicious downward cycle of dependency and growing microdebt. Just under 82% of farmers in Andhra Pradesh are in debt by the mid-2000s, the highest figure in all of India (Patel, 2007).

Crucially, because of their small size, very little additional agricultural output was actually secured by accessing so much microcredit: in fact, most subsistence farms in serious debt ground to a virtual halt. One reason was that high interest rate payments on microloans effectively pushed many small farms into financial loss-making territory. These farms then chose to slow down, or even stop farming completely, rather than rack up even *more* losses trying to fund the next agricultural cycle (see Commission on Farmers Welfare, 2004). Tragically, this reduction of output also arose because of the rising number of rural suicides in Andhra Pradesh.¹² At any rate, thanks to so many tiny subsistence farms languishing and failing outright under the burden of microdebt, while

¹¹ See ‘The Makings of a Debt Trap in Andhra Pradesh’. *The Hindu Times*, April 20th, 2006.

small more commercially-oriented family farms were increasingly unable to access capital on affordable terms and maturities, rural incomes fell by 20 per cent in Andhra Pradesh in the decade after 1993 (*Ibid*). Even worse in retrospect, it was largely the commercial failures in the rural sector that encouraged Andhra Pradesh's MFIs to move into its urban areas in search of a completely new raft of poor clients to service, with quite devastating effect, as we saw above.

All told, the most obvious result of focussing upon expanding the numbers of the very tiniest informal microenterprises, and so the de facto shift of resources everywhere out of above-minimum efficient scale enterprises and farms, is that we find everywhere the proliferation of sub-optimal 'infantilizing' local development trajectories. Almost everywhere where the microfinance model has entered into the enterprise and agricultural sectors we find little real sustainable progress has ensued and major opportunity costs are evident. There is thus a major downside and opportunity cost to what one astute critic of the microfinance model has denoted as 'the microcredit paradox': a situation where 'the poorest people can do little productive with the credit, and the ones who can do the most with it are those who don't really need microcredit, but larger amounts with different (often longer) credit terms.' (see Dichter, 2006, 4).

(b) *The microfinance model ignores the 'fallacy of composition'.*

As Amsden (2010) argues, it has been a major mistake when dealing with poverty in developing countries to assume that there is no demand constraint, and that every local economy therefore has the elastic ability to productively absorb an unlimited number of the unemployed through the expansion of the local enterprise sector. This form of Says Law – 'supply creates its own demand' – is a seductive lure for policy-makers seeking to help the unemployed through supply-side measures (such as enterprise development and training) but, as Amsden shows (see also Galbraith, 2008; 151-163), it has no basis in reality. Other things being equal, new and expanded microfinance-induced microenterprises do not raise the *total* volume of business/demand so much as redistribute or subdivide amongst market participants the prevailing volume of business/demand (on this, see Davis, 2006). This point is, of course, the 'fallacy of

¹²The cause and actual numbers of rural suicides remains a matter of hot dispute, ranging from 'just' a few hundred to several hundred thousand in total. See 'Death by microcredit', *Times of India*, 16 September 2006.

composition' and it has quite serious implications for the presumed efficacy of microfinance. Muhammad Yunus clearly misunderstood the importance of the 'fallacy of composition',¹³ however, and so the modern microfinance model was established upon a flawed foundation.

The reality in virtually all developing countries is that local economies have been saturated with simple informal microenterprises for many years: indeed, an informal microenterprise has long been the default activity for those without any type of formal employment or income – the vast majority in some countries (see Breman, 2003). In most local economies (prior to the arrival of microfinance) the high density of informal sector activities has been known for many years, as was the fact that the size of the informal sector generally varied in line with the natural growth of local demand. With the arrival of microfinance in the 1980s, however, a supply-side MFI-pushed increase in the numbers of informal microenterprises was stimulated without any compensating intervention on the demand side. This inevitably created hyper-competition, which in turn precipitated downward pressure on prices, and so also on incomes, wages, profits and working/life conditions for those already struggling in the informal microenterprise sector.¹⁴ In addition, reduced turnover per microenterprise, as local demand is taken by new microenterprises, means that the earnings and working conditions of microenterprises that do not borrow from MFIs inevitably deteriorated. Many simply collapse thanks to the new competition.

Two negative but largely unregistered outcomes are thus uppermost as a result of microfinance programs in this context: first, significant job and income displacement effects across the community and, second, significantly higher levels of exit by existing producers.

Consider first the issue of displacement. In Mexico, the typical local economy has for some time been bursting at the seams with informal microenterprises. Few market gaps remain. The result of new entry and expansion thanks to microfinance is that prices on most of the very simple products and services have been falling. In addition, lower turnover in individual microenterprises, as local market demand is shared out among a growing population of microenterprises, has been precipitating lower margins and incomes. In many sectors and in many regions of Mexico, poor individuals are hugely

¹³ Yunus's view is very clear on this - 'A Grameen-type credit program opens up the door for limitless self-employment, and it can effectively do it in a pocket of poverty amidst prosperity, or in a massive poverty situation' (see Yunus, 1989, 156).

angry at the declining margins and wages, as well as longer working hours, brought about by the unremitting inflow of ‘poverty-push’ microenterprises supported with microfinance.¹⁵

Noticeably in the wake of NAFTA in 1994,¹⁶ which quickly closed many industries in Mexico and so stimulated an extensive wave of new informal microenterprises composed mainly of the newly redundant, the end results were quite adverse. Popli (2008) reported that poverty levels in the (newly enlarged) informal microenterprise sector very rapidly increased after NAFTA. Even as some economic growth reappeared in the Mexican economy in the mid-1990s, poverty levels in the informal sector continued to rise. The simple dynamic here involved existing (and in many areas, *declining* demand, because very many small farmers after NAFTA lost their local market and incomes due to cheaper imported US corn) local market demand being shared out within the enlarged informal microenterprise sector. So, very little, if any, *net* employment or additional income was actually generated through the surge in new microenterprise entry.

Thus seen, the proliferation of MFI-financed microenterprises simply *redistributes* poverty within the poorest communities, if indeed it does not *exacerbate* it: it certainly does not *resolve* it. More importantly, the poor do not always meekly accept to pay this social cost on behalf of society, and violent reaction has all too often emerged as incumbent wages and working conditions have declined, as was the case a few years ago in Mexico’s several million strong community of mobile street vendors.¹⁷

Turning to the related issue of an MFI’s clients failing, we find, first of all, that such failure is even more pronounced in relation to informal microenterprises than in formal small enterprises because the former are generally much more likely to be established on the basis of ‘poverty-push’ factors, rather than ‘opportunity/profit pull’ factors. Failure rates of informal microenterprises are often very high indeed in developing countries (for an example from India, see George, 2006). The core problem with client failure, however, is that this event very often plunges the hapless individual into much deeper, and possibly irreversible, poverty. This is because a failed microenterprise often means the poor lose not just their already minimal income flow, but also any additional assets, savings and land they might have invested into their microenterprise or else are forced to

¹⁴ For example, see ILO, 2009.

¹⁵ See International Press Service (IPS), Mexico City, 2nd September, 2003.

¹⁶ North American Free Trade Agreement.

sell off (often at ‘firesale prices’) in order to repay the microloan. Social networks and reputational capital are also lost.

An all too real illustration of what we mean here is to be found in Bosnia. As elsewhere, Bosnia’s microenterprise sector is defined by its high failure rate, with up to 50% of microenterprises failing within just one year of their establishment (Demirgüç-Kunt, Klapper and Panos, 2007). Behind this dry statistic, however, lies the fact that a very significant number of Bosnia’s poor individuals failing in their microenterprise project have ended up in much deeper poverty and insecurity (see Bateman, Sinković and Škare. 2012). There are several reasons for this adverse outcome. First, those failing in a microenterprise but who chose (or were effectively forced) to continue to repay their microloan ended up drawing down family assets (especially family savings) and selling off other family assets - family land, housing, private vehicles, machinery, and so on. Second, many in Bosnia were forced to divert other important family income flows into microloan repayment, such as remittance income and pensions. Third, very many individuals in Bosnia got hooked into taking out multiple microloans, using each new microloan to repay existing microloans, but in the process building up a mountain of personal debt that at some point needs to be repaid. Fourth, even those quite unconnected to a failing microenterprise, such as those who guaranteed a microloan for friends and family, as is the common procedure in Bosnia, ended up severely disadvantaged by being forced to repay a microloan on someone else’s behalf.¹⁸

All told, there is no shortage of evidence from the field that routine displacement and client exit factors have frustrated the poverty reduction goals of microfinance. Partly because of the familiar neoliberal position that the ‘opportunity’ and ‘freedom’ to establish a new enterprise is all that really counts, and not other conditions, such as the capabilities of the entrepreneurs involved or if there is real demand for their simple outputs, these adverse features of the microfinance model have long been denied and/or ignored. However, the view that displacement and client failure are important factors is now increasingly accepted in many institutions (though certainly not in all).¹⁹ One

¹⁷ International Press Service (IPS), September 2nd, 2003, Mexico City.

¹⁸ See ‘*Balkan loan guarantors struggle to pay others’ debts*’ Reuters RPT-FEATURE, August 17th, 2009.

¹⁹ In 2010 the EU launched the European Progress Microfinance Facility, a major program to support the unemployed in recession-hit Western Europe. It was built on an implicit assumption that there is sufficient local demand to unproblematically underpin a new wave of microenterprises set up by the unemployed. However, the evidence the EU has used to underpin this assumption is derived from evaluations of microenterprise growth and survival undertaken in the early 2000s, which showed that there was no shortage of local demand for microenterprises. That today’s local demand situation is so

example of this new realism is the ILO's recent response to the global financial crisis and rising unemployment, which was to argue *against* further stimulation of the informal microenterprise sector, since 'As was the case in previous crises, this could generate substantial downward pressure on informal-economy wages, which before the current crisis were already declining' (ILO, 2009, 8).

(c) *The microfinance model helps to deindustrialise and infantilise the local economy*

Entrepreneurship theory and studies in institutional economics show that it is new, creative, technically innovative ideas and institutions that are the key engine in economic development (Schumpeter, 1987([1942]; North, 1990; Baumol *et al.*, 2007). To develop in a sustainable fashion, and thus to reduce poverty, developing countries need to master key technologies, better understand 'state of the art' industrial products and processes, develop at least some innovative capabilities in domestic microenterprises and SMEs, and establish a tissue of pro-active development-focused institutions and organizations (see UNCTAD, 2003; Amsden, 2007; Chang, 2007).

Only very simple and unsophisticated microenterprises can service their debts, given the interest rates and maturities demanded by most MFIs. Typically, these microenterprises are very simple trading, retail and service operations, with perhaps some very small production-based operations that can add value very quickly (such as food preparation). We also know that very few growth-oriented microenterprises or SMEs using more sophisticated technologies can effectively get started or expand with the assistance of microfinance. Especially within the 'new wave' microfinance paradigm, moreover, there is an in-built bias against longer term projects, which are likely to be of much more value to the local community but which would struggle to repay high interest rates in their initial period of operations. Nor does it help that many high-profile commercial banks are increasingly 'downscaling' out of traditional SME lending into higher profit microfinance.

Overall, then, to the extent that the financial sector shifts in favor of microfinance – as we are indeed seeing right around the globe - the more an economy's scarce financial resources are effectively directed *towards* the very simplest 'no-tech/no-capital', mainly petty trade-based microenterprise projects, and so channelled *away* from more

radically different to the pre-global financial crash period appears to have been ignored. For example, see (<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/427&type=HTML>).

sophisticated and technology/innovation-based projects that offer far more to the economy and society in the medium to longer term. That is, microfinance as development policy very clearly helps facilitate the deindustrialisation of the local economy, and so renders it quite incapable of raising the level of productivity which we know lies at the root of economic growth and poverty reduction.

Consider the case of Sub-Saharan Africa (see also Chang, 2011; 157-167). With the microfinance sector rapidly expanding this last decade, local savings and remittance incomes are increasingly being recycled (and very profitably so) into the very simplest of trade-based operations and inefficient subsistence farms. This is helping to expand Africa's already giant informal microenterprise sector (perhaps the largest in the world on a per capita basis - see African Development Bank and OECD, 2005). At the same time, however, this has effectively reduced the financial backing for the urgently required 'bottom-up' industrial transformation of Africa, particularly through reducing support for innovative and growth-oriented SMEs. In short, with the help of microfinance Sub-Saharan Africa's economic structure is increasingly becoming characterised by the 'missing middle' phenomenon – it is a continent of hundreds of millions of simple traders coexisting uneasily with a handful of large companies (e.g., oil companies and copper and diamond mines) but very little in between (*ibid*,44). Even in those countries where a natural resource bounty has made the availability of finance much less of a problem than elsewhere, such as in oil-rich Nigeria, the informal microfinance sector has ignored the obvious oil-sector related opportunities (subcontracting, servicing, etc) and demonstrated the usual overwhelming predilection to work with only the very simplest microenterprises - nearly 80% of microfinance in Nigeria (and the sector is growing rapidly at the expense of more traditional uses [i.e., SMEs]), is channelled into simple cross-border petty trade-based microenterprises (see Anyanwu, 2004).

Africa's escape from poverty and under-development simply will not be facilitated upon the microfinance-induced entry of more of the simplest 'buy cheap, sell dear' microenterprises. Africa's growth requires instead the gradual construction of a robust light industrial and agro-processing foundation that will enable its entry into at least some mainstream production and manufacturing-based enterprises capable of productivity-growth. This in turn means that Africa urgently requires not even *more* microfinance than at present, but a raft of robust and far-sighted financial institutions willing to socialise risk, carefully build productive capabilities where appropriate, and

hold steady to a longer-term development and industrialisation vision. This need is not being addressed, however. In fact, (no) thanks to Dambisa Moyo's internationally well-received book setting out her own solutions to the continued poverty and underdevelopment in her native Africa – especially her belief that very much more microfinance is needed (see Moyo, 2009; Chapter 8) – one might argue that the real solution to Africa's problems has become more elusive than ever.

In short, microfinance greatly reduces the ability of developing countries to promote their industrial upgrading as one of the keys to eventual economic success and poverty reduction. This is not only because the microfinance sector misdirects scarce resources into the wrong type of enterprise (i.e., mainly trade-based microenterprises), but also because it draws scarce development funds away from financial institutions that *are* perhaps up to the required task (e.g., Korean/Brazilian-style development banks, SME technology funds). Meanwhile, in the formerly industrially sophisticated and institutionally quite rich countries of Eastern Europe, an obvious and valuable industrial inheritance - an inheritance that most developing countries are desperately striving to possess - has been largely abandoned as the potential starting point for a new generation of relatively technology-intensive enterprises.

(d) Microfinance fails to connect with the rest of the enterprise sector

Another important factor that we now know lies behind successful local economic and enterprise development is 'connectability' between enterprises of all sizes. It is now very well understood that the tissue of horizontal (clustering, networks) and vertical (subcontracting) connections within the local enterprise sector is a crucial determinant of a local economy's ultimate sustainability through industrial development (Pyke, 1992). Indeed, as Weiss (1988; 210) concludes in reflecting on the successes of both the Italian and Japanese microenterprise and SME sectors since 1945, 'the core of modern micro-capitalism is not competitive individualism but collective endeavour'.

Wherever the microfinance model has been in the ascendancy, however, such beneficial grassroots dynamics have largely been undermined. While succeeding in terms of producing some new (albeit largely temporary) informal sector microenterprises, the overwhelming majority of these new entrants have no need, wish or ability to meaningfully cooperate in order to begin to forge the required productivity-enhancing horizontal ('proto-industrial districts') and vertical (sub-contracting)

connections. The result in many developing and transition countries has been little movement towards a more ‘connected’ local economy. This gives rise to some significant handicaps. For example, large firms are unable to expand their operations by tapping into a local structure of quality suppliers, but must import instead. A lack of potential sub-contracting partners also typically dissuades investments in large-scale operations, especially ‘greenfield’ FDI. Important cluster building programmes simply cannot function when there are few, if any, local enterprises that can meet the technology, market and scale requirements to benefit from cooperating with their counterparts.

In short, the microfinance model pays no heed to the important requirement that enterprises be of the right type (size, quality, use of technology, innovative products and processes, etc) that might both facilitate and benefit from local ‘connectability’. The microfinance model therefore operates like a football academy that exists solely in order to turn out players with individual skills, but all of whom have no ability to engage in the vital organisational cooperation – the teamwork - required to actually win the match.

(e) The microfinance model is pre-programmed to precipitate a sub-prime-style over-supply of microfinance

Hyman Minsky (1986) predicted that neoliberal policies were likely to be especially destructive when played out through the financial sector, with an inevitable tendency towards Ponzi-style booms and busts in the supply of finance. It has become increasingly manifestly apparent through a series of financial crises, culminating in the 2008 global financial crisis, that Minsky was correct. Minsky’s predictions also very much pertain to the local financial sector. Black (2005) extensively documents a Minskyian-style adverse trajectory in the shape of the boom and then spectacular bust of the US Savings and Loans (S&Ls) institutions in the 1980s.

As the growing number of ‘microfinance meltdowns’ indicates, the microfinance sector has proved very receptive to Minskyian dynamics. In fact, the massive sub-prime-style over-supply of microfinance and various Ponzi-style dynamics are now intrinsic features of the microfinance model.

Two important sub-prime-style drivers are important here. First, as in any private business, pushing out a continuously increasing volume of microcredit is the most important way that an MFI can both justify and physically provide the financial space

that allow for the generous salaries, bonuses and other perks that are increasingly the norm in the microfinance sector. All that matters is that, somehow, an MFI's clients are able to absorb whatever output of microcredit is forthcoming (even if only to repay microloans already taken out). Second, the larger an MFI becomes, the more likely it is that its senior managers will be able to benefit when the time comes for the expected transition to publicly owned company status via the IPO route. The primary mechanism that can provide for this private enrichment is found in the fact that an MFI's senior managers typically accumulate shares in their own MFI, very often using interest free loans from their own MFI to do so. These shares are then offloaded at the time of the IPO. In the two most important IPOs to date – Compartamos in Mexico, and SKS in India – senior managers were able to garner several tens of millions of dollars of personal gain from the sale of shareholdings they had built up over previous years.

In a very real sense, then, the microfinance model contains the seeds of its own destruction as a development intervention. Microfinance today is about making large sums of money for the *providers* of microfinance, not resolving the poverty situation of the poor *recipients* of microfinance (see Klas, 2011: 'Anonymous', 2012). MFIs become super-charged into selling as much microfinance as they can, and, unlike in other product markets (furniture, food, clothes, etc), it is not difficult to convince the poor that there is no upper limit to how much microcredit they can 'consume'. Both providers and recipients within microfinance are thus automatically stimulated into supply and demand excess respectively, thereby providing the fuel for the inevitable 'microfinance bubble'.

(f) The microfinance model ignores the crucial importance of solidarity and local community ownership and control

It has long been recognised that community solidarity, trust, volunteerism, equality, cooperation and goodwill are intimately and positively linked to the wider issue of 'community liveability' (for example, see Zamagni and Zamagni, 2010). But as many have argued (for example, Leys, 2001), whenever community development and poverty reduction activities are constituted as commercial operations, this quite dramatically increases the likelihood that such important outcomes for society are undermined.

In many ways the microfinance model undermines these important 'community liveability'-building processes. Perhaps most important of all, the local hyper-competition that follows in the wake of microfinance is patently unsuitable foundation

upon which to build ‘community liveability’. As Davis (2006) reports, it is *precisely* the unrelenting growth of informal microenterprises that accounts for the destruction of the sense of local community and solidarity in many developing countries. As Davis argues,

‘Those engaged in informal sector competition under conditions of infinite labour supply usually stop short of a total war of all against all: conflict, instead, is usually transmuted into ethnoreligious or racial violence ... the informal sector, in the absence of enforced labour rights, is a semi-feudal realm of kickbacks, bribes, tribal loyalties, and ethnic exclusion ... the rise of the unprotected informal sector has too frequently gone hand in hand with exacerbated ethnoreligious differentiation and sectarian violence (page 185).

Put very simply, the informal microenterprise sector simply does not possess the sort of ‘transformational power’ widely claimed for it by the microfinance industry and its ideological supporters (notably De Soto, 1989). On the contrary, hyper-competition and the resulting brutalization of poor individuals and intensification of their day-to-day workload and suffering, are an unlikely precursor to ‘community liveability’ or any other desirable economic and social development outcomes. Local solidarity is inevitably destroyed as the distorted business ethics and morals that inevitably emerge under such Hobbesian conditions gradually percolate into other enterprise structures (i.e., SMEs), other institutions (i.e., government) and across all levels of society.

3. Microfinance is used as a vehicle for neoliberalism

One of the major assumptions about microfinance is that it is ideology-free and simply about ‘helping the poor’. However, microfinance in its commercialised form is actually almost perfectly in tune with the core doctrines of neoliberalism, the reigning ideology of our time: that is, the need to vector all economic activity through private individual initiative; the need to avoid any aspect of planning or conscious guidance of the market mechanism; the need for all institutions to attempt to ‘earn their keep on the market’; and, the need to ensure that all economic organizations are also as much as possible owned and controlled by the private sector (see also Harvey, 2006). So might one of the reasons for the almost unlimited well of support for microfinance be related to the political economy of microfinance? After all, at least since the time of Marx, and more

recently re-emphasised by the conservative institutional theorist Douglass North (see North, 1990), ‘bad’ institutions are allowed to survive, and may even be encouraged to flourish, simply because it is in the interests of the powerful for this to happen. In this section, we briefly adumbrate the intimate association that clearly exists between microfinance and neoliberalism.

(a) Microfinance provides a model for poverty alleviation that is politically acceptable to the neoliberal establishment

A pervasive and continuing fear among neoliberals is that the poor will opt to use the democratic process or popular pressure to demand the establishment or strengthening of state and collective institutions capable of remedying their plight. As Bromley (1978) pointed out, neoliberals were very quick to see the informal sector in general, and, we would argue here, the microfinance sector in particular, as a way to pre-empt more radical alternatives that might upset the prevailing economic system and distribution of power and wealth.

Microfinance offers to neoliberals the hope that informal sector activities backed up by microfinance will become universally embedded as the only legitimate exit route out of poverty for both the individual and the community, thereby also removing from the political and policy agenda a wide range of progressive policies. These include demands for constructive state intervention, robust social welfare programmes, quality public services accessible to all, income and wealth redistribution (including land reform), and all forms of state, collective and cooperative ownership. This narrative helps to legitimise not only the entrepreneurial process as the core foundation of any society, but also the vastly unequal rewards (wealth and power) that inevitably arise in the process. After all, an opportunity to be successful in entrepreneurship in Dhaka, Abuja or Quito (thanks to obtaining a microcredit), or else as an entrepreneur in London, New York or Paris, essentially requires all parties to adhere to the same rules, regulations and processes: only the final rewards are different.

In this context, microfinance can be deployed to delegitimize and dismantle all possible ‘bottom-up’ attempts to propose alternative development policies that might primarily and directly benefit the majority but which would circumscribe the power and freedom of established elites. Put simply, microfinance offers to neoliberals a highly

visible way of being seen to be addressing the issue of poverty, but in a way that offers no real challenge to the existing structures of wealth and power.

(b) Microfinance can be used to undermine the concept of basic state service provision and to support privatisation and private sector provision

In a very real sense, microfinance has been consciously positioned as the longer run substitute for social welfare spending (and international donor support). Once the poor can be made to accept that they are now in control of their individual and family destiny using microfinance, it becomes much easier for the government to fully absolve itself of continued responsibility towards them. Governments can also, if they so wish, to even begin to dismantle social structures constructed after years of social mobilization and collective struggle.

For example, microfinance has been deployed as part of the goal to promote private local service provision, rather than collective service provision through the state or local community. This has been a long-time goal of neoliberal policymakers everywhere. A major aspect of neoliberal Structural Adjustment Programs (SAPs) everywhere has involved the dismantling of important public services and utilities serving the common good, and their gradual replacement with private provision based upon user fees. However, not surprisingly, almost all of these programs meet determined resistance from the poor, and this is where microfinance comes in. Because it can spread the cost of access to private provision over a longer period of time, microfinance can dampen down the initial anger inevitably felt when important services are privatised and put on a 'full cost recovery' basis. Shiva (2002) reports that microfinance programmes have been successfully used to ensure a less precipitous, and thus less politically damaging, decline in water demand after privatisation.

This short-term objective then evolves into one where it is hoped that the poor will begin to accept that they must permanently pay for service provision, and so begin to see microfinance as the only way to find the larger sums of cash required to gain regular access to private provision. Even though collective provision by the local state is usually the most efficient, including when directly compared to microfinance (for example, see Mader, 2011), in this way it might still be possible to encourage the poor to begin to rely upon much less efficient private sector provision. In some cases, unconcerned government officials and politicians hope that the poor can be fobbed off with

microfinance rather than state activity. In India, for example, Harper (2007: 258) reports that government officials are increasingly deflecting community demands to support better basic education and health services on the grounds that poor people 'now have microfinance' and should individually seek to purchase such services (albeit at high prices) from the private sector rather than through taxpayer-funded public provision.

(c) Microfinance underpins the drive towards financial sector liberalisation and commercialisation

Microfinance has played an important role in the promotion of global financial liberalisation and commercialisation. As Weber (2002) shows, MFIs that have achieved financial self-sufficiency provide working examples to developing country governments of 'efficient', subsidy-free, financial institutions. It is thus expected that all other financial institutions will have to follow suit. If a financial institution serving the poorest people can be profitable, the reasoning goes, all other financial institutions with a better clientele profile should aim for profitability as well.

Most recently, commercial funding of microfinance programmes, including the outright purchase of established MFIs by the commercial banking industry, has increasingly separated the microfinance industry from its roots in the NGO sector. As increasingly a part of the global financial complex, microfinance can be portrayed as a good example of how Wall Street and the global financial sector in general 'cares' and how it directly addresses core societal problems. At least until the global financial crash of 2008, it was hoped by many in the international development community that this 'public service function' provided by MFIs, and very publicly supported by many of the largest banks on Wall Street (e.g., CitiGroup), would contribute to obtaining continued government and public support for the ongoing liberalisation of the financial sector in general.

(d) Microfinance acts as an important 'safety valve' within the globalisation project

Perhaps the most important factor of all, however, is the 'containment' role that microfinance has been allocated within the neoliberal globalisation project. It is widely argued by neoliberals that globalisation has the potential to provide a major reduction in poverty. Yet it is hardly a coincidence that globalisation has been determinedly driven by

a handful of the wealthiest of the developed countries – by the US most of all (Gowan, 1999) – which (or rather whose elites) clearly expected to be, and have by far, been its major beneficiaries (Stiglitz, 2002; Chang, 2007). But as globalisation increasingly concentrates wealth and power into the hands of a small number of countries, regions and corporate elites, the flipside, as Faux and Mishel (2000) explain, is a growing worldwide population of the unemployed, powerless, marginalised, hyper-exploited and insecure. And the rub here is that these ‘losers’ are beginning to reject both the outcome assigned to them and, most dangerous of all for neoliberals, the globalisation process itself. Symptomatic of this rejection is the rising social unrest, increased social and gang violence, explosion in substance abuse, increasing crime and illegal business activity, huge rise in pseudo-religions and cults, collapsing levels of social capital in the community, and associated violent conflict (see Burbach *et al*, 1997).

In the potentially explosive situation emerging in many developing and transition countries today, dramatically made worse by the Wall Street-precipitated global financial crisis, and particularly acute in the growing number of ‘mega-cities’, microfinance provides a crucial ‘safety valve’. The logic is well known. Universal social welfare systems are being dismantled under IFI guidance, secure public employment opportunities are rapidly disappearing, and formal sector employment are an increasing rarity too. Nevertheless, the hope (not always a realistic one²⁰) is that the microenterprise sector can engage the most articulate and vocal of the poor, who might otherwise be thinking about resisting, or proposing realistic alternatives to, neoliberalism and the globalisation project.

4. Conclusion

This article has raised issues of serious concern relating to the contemporary microfinance model. While accepting that there are some minor and largely temporary short-run benefits for a small minority of ‘winners’, we argue that the microfinance model has very serious limitations as development policy. In very many respects, in fact, microfinance constitutes a very powerful ‘poverty trap’. We outlined the main flaws in the microfinance model. We then provided at least part of the answer as to why the

²⁰ The young and well qualified people who led the recent Arab Spring uprisings were not just risking their lives to bring down dictators, but also very centrally arguing against being stuck in petty retail and service jobs (i.e., in informal microenterprises).

international development community continues to lavishly support the microfinance model in spite of these fatal, and now increasingly well-publicised, flaws. The microfinance concept is linked to neoliberalism and the globalisation project. It is therefore supported so strongly and uncritically because it is in agreement with the international development community's preferred economic and societal model based on self-help and individual entrepreneurship. Finally, a word on what might be better local and national alternatives. We very much believe that there are better financial institution alternatives, such as financial cooperatives, credit unions, building societies and local and national development banks. Fully adumbrating the advantages of these generally community-owned and controlled alternatives would, of course, require another article (however, see Bateman, 2012; Chang, 2007).

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