

The Microfinance Illusion
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Summary. – In both developing and transition economies, microfinance has increasingly been positioned as one of the most important poverty reduction and local economic and social development policies. Its appeal is based on the widespread assumption that simply ‘reaching the poor’ with microcredit will automatically establish a sustainable economic and social development trajectory animated by the poor themselves. We reject this view. We argue that while the microfinance model may well generate some positive short run outcomes for a lucky few of the ‘entrepreneurial poor’, the longer run aggregate development outcome very much remains moot. Microfinance may ultimately constitute a new and very powerful institutional barrier to sustainable local economic and social development, and thus also to sustainable poverty reduction. We suggest that the current drive to establish the central role of microfinance in development policy cannot be divorced from its supreme serviceability to the neoliberal/globalisation agenda.

Key words: microfinance, poverty reduction, Bangladesh, Bosnia, neoliberalism, globalization

1. INTRODUCTION

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, financial cooperatives, state-owned banks for SMEs (Small and Medium-sized Enterprises), social venture capitals funds, and specialised SME funds. The recent explosion of interest in microfinance is something quite new, however. It largely reflects the ‘discovery’ in the 1980s of a supposedly new paradigm of microfinance institution (hereafter MFI), one that appeared to be able to robustly address poverty through the expansion of tiny informal sector income-generating projects, whilst apparently also able to survive by ‘earning its keep on the market’.

Spearheading this new paradigm was the Grameen Bank in Bangladesh, an MFI established in 1983 by Dr Muhammad Yunus. As one of the earliest and most successful pioneers of the ‘solidarity circles’ methodology, wherein joint guarantees by groups of borrowers encouraged very high repayment rates on microloans, the Grameen Bank appeared to be able to sustainably provide hundreds of thousands of microloans to the very poorest in Bangladesh (Yunus, 2003).¹ Crucially, newly armed with a microloan, it was assumed that the ‘entrepreneurial poor’ were then busy establishing and expanding all manner of income-generating projects, thus ensuring their aggregate and permanent escape from poverty.

¹ In actual fact, as Morduch (1999) later pointed out, the Grameen Bank was quietly in receipt of substantial government and donor financial support right from its inception.

2 For example, CGAP reports that “Microfinance is experiencing an unprecedented investment boom. The past five years have seen remarkable increases in the volume of global microfinance investments. Between 2004 and 2006, the stock of foreign capital investment—covering both debt and equity—more than tripled to US\$4 billion”. CGAP Focus Note 44, February 2008.

3 For example, see Rogaly (1996), Nissanke (2002), Bateman (2003, 2007a, 2008), Rahman (2004) and Dichter (2007).

4 See ‘Online Extra – Microlending: It’s no Cure-all’, Businessweek Online, December 13th, 2007).

5 Indeed, very recent evidence from a survey of 45 countries strongly suggests that microloans have little impact on GDP per capita growth compared to enterprise loans (see Beck et al, 2008).

6 At the same time, all ideas for alternative local financial systems of some relevance to microenterprises and SMEs were expressly forbidden or undermined, such as an idea proposed by some of Bosnia’s best economists to establish an SME Development Bank (see Bateman, 2003).

7 See “A Handout, not a hand up: A popular approach to ‘sustainable development’ doesn’t work, critics say”, Boston Globe, Nove 11, 2007.

Given the growing dominance of neoliberalism in the international development community at the time, the Grameen Bank represented something of a revelation. Here, as Robinson noted (Robinson, 2001), was a radically new way of dealing with poverty and under-development, while very much accepting neoliberalism’s determined focus on the unquestioned application of market forces and private individual entrepreneurship. From then on, the ‘success’ of microfinance was overwhelmingly judged on the basis of the financial sustainability of the MFI itself: that microfinance made a positive development and poverty reduction impact within the local community was assumed as given. ‘More microfinance’ became fully interchangeable with ‘more poverty reduction’. International donor, NGO and high level political support were critical in helping this ‘new wave’ microfinance paradigm to spread so rapidly after the Grameen Bank was ‘discovered’ (see Otero and Rhyne, 1994). The US government’s USAID arm was one of the first organisations into the microfinance field, right away pushing ‘new wave’ microfinance as ‘best practise’. Several US-based NGOs also quickly directed their poverty alleviation efforts into the ‘new wave’ microfinance arena, notably Boston-based Acción. After first dismissing microfinance as a less than serious business and poverty reduction methodology, and also a little ‘too leftist’ for it to offer any support, in the late 1980s the World Bank began to provide significant technical advice and financial support for new microfinance programmes. It also took the lead in establishing CGAP (Consultative Group to Assist the Poor), a multi-donor institution effectively dedicated to the promotion of the ‘new wave’ MFI concept. High profile independent campaigns, such as the MicroCredit Summit Campaign, helped to push the microfinance idea into the

wider public arena. The UN joined in, providing funds through a number of its arms (e.g., UNDP, UNCDF) and then nominating 2005 as the 'International Year of Microcredit'. Very soon a large number of high-profile individuals in the movie business, royalty, the music industry, big business and politics became convinced of the benefits to the poor of microfinance. Genuinely wanting to 'do good', these VIPs and celebrities helped raise microfinance to new heights of popularity and 'cool', in the process making all criticism of microfinance seem to be 'uncool' and even the work of those quite unconcerned with the plight of the poor. Apotheosis for the microfinance movement came in 2006, with the award of the Nobel Peace Prize jointly to Dr Muhammad Yunus and the Grameen Bank. Microfinance's supposed success in the 1990s effectively gave rise to two more developments that are potentially 'rule-changing' in scale and scope. First, private financial investors have become convinced that very healthy profits can be realised by making timely investments in microfinance. The result since around the turn of the new millennium has been a dramatic rise in the flow of private investment capital into the microfinance sector.² Second, the microfinance industry has also begun to benefit hugely from financial support offered by the so-called 'new money philanthropists', notably such as Bill Gates and eBay founder Pierre Omidyar. Even moderately rich individuals are increasingly accepting the idea that they can perform no better service to humanity than by passing on their accumulated wealth to the microfinance sector (for example, see Smith and Thurman, 2007).

By the early 1990s, however, it was becoming clear that the original Grameen concept – microcredit provided to establish or expand income-generating projects – was transmuting into the much wider concept of microfinance, meaning the supply of a whole range of financial services to the poor, including microcredit, micro-insurance, micro-savings, and so on (see Hulme, 2008). In particular, as Dichter (2007) has stressed, it was becoming quite clear that most microcredit is actually used not so much for income-generating projects, but mainly to facilitate consumption spending. While consumption smoothing is a useful survival technique, this transformation represents a quite dramatic break with the original Grameen Bank innovation. Notwithstanding, support for microfinance as poverty reduction and 'bottom-up' development policy has continued virtually unchanged.

This article disagrees with much of the rationale presented in support of microfinance. In fact, we see a growing number of reasons to believe that microfinance may actually be undermining attempts to establish sustainable economic and social development, and so also sustainable poverty reduction. Microfinance may even constitute a new and very powerful form of 'poverty trap'. We say this because of three inter-related issues.

First, a growing number of independent analysts have argued that the hugely optimistic narrative constructed around the microfinance model is actually rather seriously flawed, if indeed it is not, as Lont and Hospes (2004:3) contend, "in many respects a world of make-believe."³ Importantly, Ellerman (2007) raises some very serious methodological objections to the 'impact evaluation' exercises that are widely used to 'prove' the positive impact of microfinance. All told, unsettling evidence on the ground has given rise to serious doubt about the benefits of microfinance, including on the part of many long-time high-profile advocates of the microfinance model (for example, see Dichter and Harper,

2007). Even Jonathan Morduch, the co-author of a major international textbook on the economics of microfinance and long time microfinance advocate, admits that, while economic theory suggests micro-finance has benefits, “[r]igorous evidence that shows it happening just doesn’t exist. The evidence is pretty dicey”.⁴ A second related problem we have with the dominant microfinance model is that it has not unambiguously resulted in a sustainable poverty reduction and economic development episode anywhere. Indeed, exhaustive analysis of those countries that reached developed status in the 1800s and early part of the last century (the USA, western Europe and Japan) as well as the fastest growing countries of the last thirty years or so (China, Taiwan, South Korea, Thailand, India, Malaysia and most recently Vietnam), show that the microfinance model has played no role whatsoever. To the contrary, these countries have very successfully reduced poverty and have grown rich(er) overwhelmingly by using a range of state coordinated policy interventions, financial institutions and investment strategies that are not only the complete opposite of today’s ‘new wave’ microfinance model, but also - and this is the rub for those in the microfinance industry that might argue for ‘policy co-existence’ – very likely to be undermined by the proliferation of microfinance and its prior claim over savings and other important financial resources (see Wade, 1990; Amsden, 2001; Chang, 1993, 2002, 2007).

The final concern we have with the microfinance model is its intimate relationship with neoliberalism and the globalisation project. As we will show below, particularly by emphasising individual entrepreneurship over all other forms (state, cooperative, etc), the microfinance concept has strong political/ideological serviceability to the prevailing neoliberal/globalisation model. This association is extremely problematic, because there is much evidence to suggest that policies and institutions could be deliberately favoured simply because they support neoliberalism and the globalisation project, and for no other reason than this.

We feel there is an urgent need, therefore, to probe much deeper into the sustainable development impact of the increasingly widespread microfinance model, especially with regard to the ‘new wave’ microfinance concept pushed through since the early 1990s. Critically examining the available evidence and trends in many supposedly ‘best practice’ cases should help us separate the reality from the hype and the rapidly proliferating myths surrounding the supposedly awesome power of microfinance.

The rest of the article is structured as follows. Section 2 critically examines the microfinance model in a number of areas where, we feel, it is most problematic. Section 3 briefly sums up the intimate links between the neoliberal globalisation project and microfinance. Section 4 summarises the discussion and draws theoretical and policy implications.

2. ASSESSING THE SUSTAINABLE IMPACT OF MICROFINANCE

In this section we adumbrate a number of factors that we consider pivotal to understanding the real and sustainable impact of microfinance. While the relative magnitudes of such factors have yet to be established (though we give some pointers

through our examples), the fact that such problematic issues exist but are rarely, if ever, factored into the overall assessment of the microfinance model is – to say the least – troubling.

(a) Microfinance ignores the crucial role of scale economies

For all enterprise sectors there is an accepted minimum efficient scale of production below which it is virtually impossible to survive. Experience from countries such as Italy after 1945 (Weiss, 1988), South Korea and Taiwan from the 1970s onwards (Wade, 1990; Chang, 1993) and most recently China since the early 1980s (Naughton, 1995) shows how crucially important it is to invest in small enterprise units (including in agriculture) that can rapidly achieve minimum efficient scale of operations. A sufficient level of investment is paramount to a micro-enterprise's survival and eventual growth, and thus also to it materially contributing to a local sustainable development dynamic and poverty reduction.

However, MFIs promoting the entry of large numbers of microenterprises largely refuse to register the crucial importance of scale within any sector. The result is that each microenterprise has very little chance of surviving within its own locality or market. High microenterprise turnover is therefore the universal norm. This often imparts a serious cost upon those failing, as we shall outline below. Moreover, an over-supply of inefficient microenterprises undermines the development of more efficient SMEs in the same locality. For example, microenterprises are forced to survive by drastic cost-cutting strategies, which in the short run can take crucial market share away from local SMEs that might otherwise be able to reduce unit costs and register productivity growth in the long run. Perhaps most important of all is the fact that the microfinance sector everywhere is increasingly absorbing a larger and larger percentage of the financial resource base (i.e., savings) which it then recycles into simple household microloans. Because we know that SMEs are the most important likely sources of formal employment and growth in most developing and transition countries (see UNCTAD, 2003), we think this is a deeply damaging trend. everywhere is increasingly absorbing a larger and larger percentage of the financial resource base (i.e., savings) which it then recycles into simple household microloans. Because we know that SMEs are the most important likely sources of formal employment and growth in most developing and transition countries (see UNCTAD, 2003), we think this is a deeply damaging trend. everywhere is increasingly absorbing a larger and larger percentage of the financial resource base (i.e., savings) which it then recycles into simple household microloans. Because we know that SMEs are the most important likely sources of formal employment and growth in most developing and transition countries (see UNCTAD, 2003), we think this is a deeply damaging trend.

India is a good example where a growing percentage of financial resources are being channeled through often highly efficient (i.e., financially self-sustaining) 'new wave' MFIs, but increasingly into highly inefficient microenterprises. This microfinance-induced 'adverse selection' process is now increasingly coming to be seen as negatively related to the chances of sustainable growth and development in India. For example, Karnani (2007:39) reports that the lack of scale economies in the microenterprise sector

is seriously damaging the Indian economy's growth potential, concluding 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'.

The area where microfinance has particularly ignored the crucial issue of scale is in agriculture. In general, the terms and conditions involved in microfinance are simply not suitable for the goal of promoting sustainable agriculture (see Harper, 2007a). The practical result of microfinance is the proliferation of quite unsustainable agricultural units, and the 'primitivisation' of the agricultural sector. In Bosnia, for example, many poor individuals signed up to receive microfinance in order to purchase a cow in order to generate a little additional income from the sale of raw milk. While this was widely seen as a very sensible and compassionate intervention by the international donor and NGO community, the development outcome was extremely problematic. The local over-supply of raw milk in many communities led to a general price decline. This undermined all incumbent producers, of course, but especially other non-client 'one-cow farms' who quickly saw reduced margins and incomes, and were thus more likely to fall into poverty than before. However, it also had a negative longer run effect by undercutting the day-to-day operations of potentially sustainable larger dairy farms. It was, for example, made more difficult for them to generate sufficient internal finance in order to reinvest in new stock and equipment (see Agripolicy, 2006). All told, microfinance largely served to raise the structural barriers preventing the emergence of a growth-oriented dairy sector in Bosnia. Bateman and Sinkovic (2007) point out that after 1995 microfinance in neighbouring Croatia went down the same dairy sector route as in Bosnia, and it produced almost exactly the same negative structural outcome.

The profit-driven channelling of large quantities of microfinance to tiny subsistence farming units that are simply not equipped for it, appears to have reached new heights of misadventure in India. India's large population of subsistence farms (650mn people live on the land, with 80% of farmers owning less than two hectares) clearly require external support, but many argued this should not be in the form of commercial microfinance. The current and potential returns from subsistence farms are simply too tiny and too insecure to justify engagement with commercial microfinance. Notwithstanding such concerns, commercial microfinance pushed its way in and has entrapped several hundreds of thousands of the very smallest farms in a vicious downward cycle of dependency and growing debt, with around 160,000 farmer suicides since 1997 an indication of the level of project failure and abject despair that has resulted (see Shiva, 2004; Sharma, 2006).

Of course, some microfinance-assisted microenterprises units have survived in many countries in spite of their initial lack of scale. But these survivors tend to be the exceptional 'outliers'. In the main, in too many developing and transition countries, the ongoing material support for the perpetuation and extension of such ultimately unsustainable enterprise and agricultural structures, as opposed to their conversion and upgrading into sustainable organizational structures, has manifestly only added to the huge structural problems and financial responsibilities that already confront communities and hard-pressed governments.

(b) Microfinance ignores the problem of 'fallacy of composition'.

The informal sector everywhere serves as the final destination of almost all MFI activities. However, this does not mean that the informal sector has the unlimited power to simply expand and absorb an unlimited number of poverty-push microenterprises. Other things being equal, in developing and transition countries today, informal microenterprises increasingly do not raise the total volume of business so much as redistribute or subdivide the prevailing volume of business. The local economy quickly becomes 'saturated' with informal sector microenterprises - street vendors, cross-border traders, kiosks, food outlets, small repair shops, taxis and other forms of cheap transport and small retail outlets. Crucially, given the nature of the activities, there are likely to be almost no further productivity-driven gains to be made in these struggling sub-sectors. Likewise, the romantic vision of informal microenterprises growing into formal sector enterprises holds very little water indeed: experience, after all, shows that only a very tiny number of formal sector enterprises start out as informal sector units (for example, see La Porta and Schleifer, 2008). Instead, the struggle for survival in poor communities, both marginalised rural communities and the growing number of urban slum communities, is typically made worse because of the continued inflow of microfinance-induced new entrants into the limited range of things that these people can take up, given their limited capabilities to diversify. We have here a very powerful 'fallacy of composition' argument against microfinance.

In developing and transition countries, market 'saturation' and displacement effects are very widespread and growing. This is confirmed both by high-profile inter-governmental reports (e.g., UN Habitat, 2003) as well as much independent research (see Breman and Das, 2000; Breman, 2003; Davis, 2006). Microfinance helps to precipitate a decline in incomes, wages, profits, and working/life conditions in many localities in the developing and transition countries, very noticeably within the increasingly-dominant urban slums. As Davis (2006:182) explains, this is because the "(the) space for new entrants is provided only by a diminution of per capita earning capacities and/or by the intensification of labour despite declining marginal returns".

Consider Bangladesh, the 'home of microfinance'. It is extremely worrying, first of all, that informal sector employment in microenterprises is coming to dominate in all its large cities. For example, more than 63% of the employed population in the capital city of Dhaka is now located in the informal sector, a sizeable rise over the last thirty years (UN Habitat 2003: 103). Individual survival in Bangladesh is today typically attempted via an informal microenterprise, which is expected to survive against a backdrop of 'market saturation' and a constant inflow of new poverty-push entrants. The result in most cities is a hyper-competitive microcosm of informal sector activity which, among other things, serves to maintain very low, and declining, rewards for such simple microenterprise activities. Indeed, Osmani (1989) pointed out very early on that constant new entry helps to push down the returns in incumbent microenterprises to below the cost of borrowing. And this difficult situation has been greatly exacerbated today, as Huq (2004) reports, by the fact that very high interest rates are being charged by the many new commercial 'new wave' MFIs. Even worse, for the growing number of poor individuals in Bangladesh failing in their attempts to establish a microenterprise, the future is often very bleak indeed. This is because when the microenterprise fails, the microloan has to be repaid by selling long-held family assets (equipment, land, buildings, etc), further indebtedness

(e.g., taking out a second microloan to repay the existing microloan) and the diversion of other income flows (remittances, pensions) into repayment. This 'fallback' strategy helps to account, of course, for the generally high repayment rates everywhere, alongside the growing evidence of rapidly rising microenterprise failure rates. However, if the majority of microenterprises fail (as we know is the case), then these hapless individuals are effectively plunged into deeper asset and income poverty than before they accessed their microloan. Even worse, with both the international development community and various levels of the Bangladesh government for a long time actively encouraging the replacement of many basic social welfare programmes and entitlements with Grameen-style NGO programmes (Karim, 2008), the problem is manifestly exacerbated. This is a potentially massive, but still largely unregistered, drawback to microfinance in Bangladesh (though some do touch upon the issue - see Hulme and Mosley, 1996, Chapter 12; see also Davis, 2008).

All told, there is actually surprisingly little real evidence to suggest that the microfinance model in Bangladesh has succeeded in establishing a sustainable and generalisable exit mechanism out of poverty. It is striking that compared to its neighbouring South and East Asian countries, Bangladesh is one of the least successful in sustainably reducing poverty and promoting 'bottom-up' productive enterprise development (Osmani, 2005; Chowdhury and Ali, 2006). Why this difference? Put simply, we would argue that while Bangladesh has encouraged the MFI sector to recycle an increasing proportion of domestic savings (and international aid) into mainly unsustainable informal sector microenterprises (e.g., rickshaws, subsistence farms, petty traders, street sellers), neighbouring South and East Asian countries have more aggressively tried to recycle their domestic savings into larger, more sophisticated, innovation-driven, technology-intensive, and thus likely to be more growth-oriented enterprises (for example, see Chang, 2006).

The increasing informalisation of Latin America is also well known, with the informal sector more than doubling since the 1980s. However, contrary to the confident prediction of Hernando De Soto (1989), massive expansion of the informal/extra-legal sector has manifestly not established a suitable foundation for sustainable development. For one thing, as Roberts (2004) argues, the massive growth of the informal/extra-legal sector was mainly associated with downward pressure on average incomes and a worsening of working conditions in poor communities. This downward dynamic was particularly felt in the growing number of urban slums (UN Habitat, 2003). Worse, the ever-expanding microfinance-induced 'saturation' trajectory in Latin America is intimately associated with increased levels of violence and urban conflict, and thus less chance of business investment. As Davis (2006: 185) has strongly argued, the growth of unregulated informal sector competition has inevitably ended up being regulated instead by those with power, connections and muscle.

We can also find the very same 'saturation' and displacement effects undermining sustainable development in what are widely seen as fast-growing developing economies. In India, for instance, the retail sector was already over-crowded with small shops, on some counts directly providing up to 40mn stable jobs which in turn support more than

120mn dependents. Yet in spite of the obvious risks associated with over-capacity, the microfinance industry has continued to support such risky sectors. Many problems have arisen. In 2007 the Indian government was forced to close down many MFIs in the state of Andhra Pradesh that (in an obvious echo of recent Wall Street tactics) were 'hard selling' microfinance and putting their own growth and profitability in a crowded market way ahead of the ability of poor clients, including very many new tiny retail outlets, to productively use and repay any microloan (see Ghate, 2007).

Finally, we find a similar problematic situation in the transition economies of Eastern Europe. Poland's supposed 'microenterprise miracle' has not stood up at all well to the test of time. Among other things, Bateman (2006) points out that there were very significant displacement effects thanks to market saturation, especially in small-scale retail and rural farming units. The overall result was very little real net employment, net additional income or local/rural poverty reduction and economic dynamism. Like Poland, Bosnia also saw an MFI-sponsored expansion of simple retail outlets, and similar displacement problems. All told, we can say that MFIs right across the developing and transition economies are clearly unable or unwilling to react to the well-known problem of the 'fallacy of composition'. Most MFIs prefer to 'look away' from the almost insurmountable problems likely to face their new poor clients with limited capabilities to diversify in already 'saturated' local markets. And so long as microloan repayment can be secured from other sources of income unrelated to the original microloan (see above re: Bangladesh), then MFI sustainability and the surface appearance of progress can be maintained.

(c) Microfinance acts to 'crowd out' industrial microenterprises with prospects of technological upgrading.

Entrepreneurship theory and studies in institutional economics both hold that it is new, creative, technically innovative ideas and institutions that are the key catalysing factors in economic development (Schumpeter, 1987; Drucker, 1985; 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 and manufacture at least some of their own innovations in domestic microenterprises and SMEs, and establish a tissue of pro-active development-focused institutions (see UNCTAD, 2003; Amsden, 2007; Chang, 2007; Oyelaran-Oyeyinka and Rasiah, 2009).

In developing countries, first, microfinance not only does not address these core sustainable development imperatives, it notably counter-acts them. In stark contrast to some of the EU and East Asian states where the microenterprise sector was strongly promoted as an agent of technology absorption and diffusion and local technology development (Italy, Germany, Japan and Taiwan most noticeably), most developing countries simply cannot use 'new wave' microfinance to attempt to forge such important links. Rather, the only possible role for 'new wave' microfinance in the developing countries is to support simply those very simple microenterprises that can repay their expensive microloans in the short time period allowed. This is reflected in the growing

commercial presence of major western banking groups in developing countries (e.g., CitiGroup and Barclays in Mexico), and the rising number of indigenous commercial banks 'downscaling' into microfinance in their own country (e.g., ICICI Bank in India). These large financial institutions are proving to be extremely adept at harvesting local savings in even the very poorest of communities, often using new forms of ICT. In many developing countries, 'new wave' MFIs, too, are much more aggressively moving into savings mobilisation. All told, to the extent that local savings are increasingly deployed in this manner then the relative absence of important technologies and innovations can only become more marked. This suggests potentially huge consequences for developing country attempts to escape under-development.

An equally pessimistic situation exists in the transition economies that emerged from the collapse of Communism. Here, too, local savings have been massively recycled back into simple microloans (see Turner, 2008). Consider the situation in South East Europe. In the late 1980s, the region possessed a significant endowment of relatively advanced technologies, some world class companies operating at or near the technology frontier, a highly skilled and entrepreneurial population, high quality R&D institutions and an advanced educational system. And although the ravages of economic collapse, political chaos, speculation and the 1992-95 civil war undermined much of the not inconsiderable legacy, it was not destroyed by any means. Among other things, such an endowment provided the obvious 'entry point' for sustainable 'bottom-up' development and growth through rafts of relatively sophisticated microenterprises and SMEs (see Ellerman, 2005). However, rather than work to support – or at least not hinder – the transformation of a major industrial inheritance into as many relatively sophisticated, technology-intensive microenterprises as possible, it can be argued microfinance has effectively undermined the chances of this scenario emerging in the region. A good illustration would be Croatia. As Kraft (2006) outlines, household microloans dramatically rose from almost nothing in 2000 to nearly 35% of GDP by 2005, probably the highest share in Eastern Europe: meanwhile, not unconnected to this is the fact that the lack of bank credit remains a major barrier to SME establishment, growth and new technology acquisition in Croatia.

Second, and equally important, is the fact that the microfinance model itself contains an 'adverse selection' bias. Put simply, entrepreneurs wishing to work on relatively sophisticated projects are generally unable to service the onerous terms and conditions offered by local MFIs, whereas the simplest of microenterprises are generally offered as much continued support by their local MFI as they can handle. The situation that ultimately transpired in Bosnia probably best exemplifies the dangers of microfinance in this specific 'adverse selection' context. With its significant military-industrial complex as the obvious entry point for many microenterprises, Bosnia thus had considerable potential to draw upon technology, innovation, international markets and high skills. But this huge potential was largely wasted, even though Bosnia was considered a unique 'test-case' for the microfinance model and received significant funds after 1995 (probably around \$100mn at least in the first decade – Bateman, 2007a) in order to support the establishment of a network of MFIs offered by local MFIs, whereas the simplest of microenterprises are generally offered as much continued support by their local MFI as they can handle. The situation that ultimately transpired in Bosnia probably best exemplifies the dangers of microfinance in this specific 'adverse selection' context.

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How this was mainly done can be usefully illustrated by the experience of Energoinvest, once one of Bosnia's most technically-advanced, innovative and R&D-driven companies (see Bateman, 2007a). Seeking ways to drastically reduce its workforce after 1996, Energoinvest offered its employees support to move into self-employment if they wished to do so. Such a company represented an almost ideal practical 'breeding ground' for new and spin-off ventures based on reasonably sophisticated and innovative product and process ideas. Potential entrepreneurs had prepared business plans based upon reaching 'break-even' point in a couple of years. But with microfinance virtually the only local financial offer to be found, as intended, most potential entrepreneurs quickly realise that they would simply not be able to meet the strict conditions required by the new MFIs, at least in their early years of operation. The result was that virtually all of the potential new small business ideas arising from Energoinvest employees were aborted. Some individuals chose to 'downgrade' their business plans into something that the MFI sector would be willing to finance, such as a simple trading venture. Tragi-comically, a number of potential entrepreneurs took advantage of a German government scheme offering support to set up new technology-intensive businesses – but in Germany.

In short, microfinance cannot be used to promote industrial upgrading in developing countries. Moreover, the microfinance sector draws scarce development funds away from financial institutions that are perhaps up to the 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 microenterprises and SMEs.

(d) Microfinance ignores the need to promote vertical and horizontal 'connectability'

It is now 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 and progress. As Weiss (1988) concludes in reflecting on the successes of both the Italian and Japanese microenterprise 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 grass roots 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. That is, the basic 'raw material' required for 'connectability' is simply not being produced. It is as if the local football academy insists on turning out only players with excellent individual skills but no understanding whatsoever of the importance of teamwork.

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 quality local structure of suppliers, but must import instead. A lack of potential sub-contracting partners also typically dissuades investments in large-scale operations, especially 'greenfield' FDI (Porter, 1990). Important cluster building programmes simply cannot function when there are few, if any, local enterprises with the technology, market and scale requirements to benefit from cooperating with their counterparts.

(e) Microfinance encourages an unsustainable import-dependent and trade-based local economic structure

One of the most damaging features of the neoliberal programmes that developing countries were forced into during the 1970s and 1980s was the collapse in local manufacturing and agricultural production brought about by instant trade liberalisation and an ensuing flood of (often subsidised) imports. Thanks to the proliferation of 'quick and easy to enter' small shuttle trading and importing ventures, import dependence has often been quickly embedded into local economies undergoing rapid liberalisation. It has also greatly helped here that commercial banks in many developing and transition countries have increasingly recycled savings back into profitable household microloans, the growth of which, as Turner (2008) highlights, is now very closely associated with the stimulation of consumer goods imports and serious balance of payments problems in many countries, particularly in Eastern Europe. Typically, the debilitating longer-run impact of excessive import dependency ultimately destroys any short-term poverty reduction gains made during an initial phase of micro-enterprise expansion in shuttle trading and importing.

Typical examples of what most often happens include Cambodia and Kosovo, two of the poorest countries/regions in the world yet with several of the most celebrated MFIs (i.e.,

ACLEDA in Cambodia, and Pro-Credit in Kosovo). As Bateman, (2007b) points out, in both countries/regions, it is clear to all that the agricultural sector holds out the most - if not only – opportunity to really help develop the local economy and reduce poverty. However, the main MFIs overwhelmingly prefer to focus instead on working with the far more profitable and quick turn-around petty trading sector, especially shuttle traders. The end result has been the construction in both countries/regions of a ‘bazaar economy’ of quite spectacular proportions, but meanwhile the faltering agricultural sector has effectively been allowed to decline (Cambodia) or collapse (Kosovo). Thus seen, high profile MFIs seriously risk becoming mere ‘cathedrals in the desert’ – centres of financial wealth and power, but totally disconnected from the fate of those struggling in the surrounding desert of poverty.

(f) Microfinance ignores the crucial importance of solidarity and local community ownership and control

By recasting individual survival as a function of individual entrepreneurial success facilitated through microfinance, the bonds of solidarity, shared experience and trust that exist within poor communities are undermined. This is a truism. More specifically, as Leys (2001) argues, recasting community development and poverty reduction activities as commercial operations – the central operating principle of the ‘new wave’ microfinance model – quite dramatically increases the likelihood of a reduction in local solidarity, interpersonal communication, volunteerism, trust-based interaction and goodwill. Interestingly, many analysts wrongly portray the Grameen Bank’s famous ‘solidarity circles’ as evidence of it building social capital/solidarity in the community. While the Grameen Bank did indeed very successfully tap into pre-existing stocks of local social capital/solidarity in order to ensure high repayment rates, over the longer term it is increasingly being recognised (for example, see Rahman, 2001; Karim, 2008b) that the intense social pressure and tendency to violence, and routine ‘shaming’ of female loan delinquents, ultimately actually destroyed social capital/solidarity in the community. In addition, the intimate association everywhere between microfinance and the rise of the informal sector has unequivocally resulted in the de-legitimation of legal process, undermined respect for the tax system, sanctioned a casual approach towards health and safety and environmental regulations, and has undermined the ability of democratically mandated governments to prohibit sharp business practises. Increasingly, a business either has to travel the ‘low road’ practises of the rapidly expanding informal sector, or it is forced under. 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), institutions (i.e., government) and across all levels of society (see Davis, 2006).

An equally worrying development that has surfaced recently, however, is the eventual impact on local solidarity of the playing out of the standard commercialisation imperatives within a ‘new wave’ MFI. By first engaging with poor communities under the watchful eye of the international donors and funding bodies, but then abandoning these same communities as they move off in search of maximum profits for senior managers and external shareholders, ‘new wave’ MFIs are increasingly looked upon with

cynicism and mistrust. Unlike credit unions or financial cooperatives, where community ownership and control largely ensures that the institution remains true to its founding principles of community development and intergenerational solidarity, today's MFIs are increasingly keen to become businesses themselves. The conscious injection of Wall Street values and methods into 'new wave' microfinance in recent years (see Drake and Rhyne, 2002), has inevitably validated similar forms of unethical behaviour, greed and opportunism on the part of those working in MFIs. The inevitable end result has been a push by senior individuals for dramatic personal enrichment, including eventually their taking over ultimate ownership of the MFI itself. Perhaps the most spectacular case to date of such MFI 'degeneration' is that of Mexico's Compartamosbanco, which saw its senior managers turn themselves into multimillionaires in little more than a decade, while asking its poor, mainly female, clients pay interest rates of around 90-100% (previously as much as 120%) on their tiny microloans (see Bateman, 2009).

Put simply, the core Wall Street-style commercialisation imperatives associated with the 'new wave' model inevitably leads on to the de facto 'capture' of an MFI by its own officials and close friends, and its subsequent conversion into a financial vehicle primarily designed to satisfy a private enrichment agenda. An MFI then generally ends up destroying much, if not all, of the valuable reserves of local solidarity it might have initially existed in the local community. For most 'new wave' MFIs, therefore, commitment to the poor and poverty reduction have inevitably become distant secondary considerations, increasingly 'demonstrated' mainly through PR puffs, such as Social Performance Management (SPM).

3. MICROFINANCE AS A VEHICLE FOR NEOLIBERALISM

We have charted a number of developments and trajectories that appear to us to seriously undermine the general case for supporting microfinance as a development and poverty reduction tool. In spite of quite inconclusive evidence of positive impact, as even its own advocates concede, the microfinance bandwagon 'goes marching on'. Might one of the reasons for this unlimited well of support 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.

One of the major assumptions about microfinance is that it is ideology-free and simply about 'helping the poor'. However, microfinance 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). 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 of state and collective institutions capable of remedying their plight. Neoliberals were therefore very quick to see the usefulness of microfinance to pre-empt such possibilities. Microfinance could 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. To the extent that micro-entrepreneurship backed up by microfinance becomes universally embedded as a major legitimate exit route out of poverty for both the individual and the community, especially with regard to women (see Feiner and Barker, 2007), a wide range of progressive policies can be removed from the political and policy agenda. These include demands for constructive state intervention, land ownership reform, robust social welfare programmes, quality public services accessible to all, income and wealth redistribution, and all forms of state, collective and cooperative ownership.

Importantly, following in the footsteps of pioneering labour market programmes in the UK in the 1980s (see Harvey, 2006), it was soon understood by the international development community that the informal sector and microenterprises represent supremely disempowering labour market outcomes. With their blessing, developing country governments were thus encouraged to use microfinance programmes as a way to 'flexibilise' the labour market and to disempower labour, very important neoliberal objectives in their own right. At the same time, neoliberals appreciate that an emphasis upon microfinance can greatly help to embed 'further down' in society their preferred idea that development is a process mainly involving individual entrepreneurial activity, and certainly not involving state intervention (for example, see Friedman and Friedman 1980). This 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. Microfinance thus offers to neoliberals a highly visible way of being seen to be addressing the issue of poverty, but in a way that offers no challenge whatsoever to the distorted structures of wealth and power that historically are mainly responsible for the creation and perpetuation of poverty.

(b) Microfinance underpins the concept of financially self-sustaining economic units and discredits the notion of public support (e.g., subsidies) for organizations

As noted above, perhaps the most attractive initial feature of the Grameen Bank experiment to neoliberals was that it was a non-governmental initiative and seemingly operating without financial support from the state. The core idea arising from Grameen - that all MFIs could and should be encouraged to survive by 'earning their keep on the market' - quickly became the standard policy advice to governments and 'best practise'

operational advice for all MFIs. In an era when many state-subsidised finance programmes were seen as under-performing (Adams et al, 1984), an independent and seemingly financially self-sustaining organization represented an extremely attractive proposition. And in practise, there was real determination on the part of the international donor community to populate developing and transition countries with Grameen-style MFIs. Alternative local financial institutions suggested by local policy elites, mainly targeted at supporting the SME sector, were routinely undermined or even blocked outright.

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

The IFI mantra in the 1980s, particularly within the World Bank, was for public provision of social services to be privatised and/or to support their existence on the basis of 'full cost recovery'. In many areas, however, the imposition of privatisation and/or user fees resulted in a catastrophic decline in the 'client' base (education and healthcare were two of the areas most affected). More recently, experiments where user fees have been abandoned have produced very positive direct results in terms of the take-up of important services, leading even mainstream critics to increasingly question the donor-driven paradigm of 'making markets work for the poor'.⁷

Nevertheless, the longer run aim of replacing most state provision with private provision still very much remains the operative goal of the IFIs and most parts of the international donor community. And in this context, 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. By accessing microfinance, poor people are still able to access services involving a user fee of some kind, because they can spread the cost of access over a longer period of time. This has often been the case, for example, in the controversial largely IFI-driven privatisation process involving the water supply industry in many developing countries. Microfinance programmes have been deliberately used to ensure a less precipitous, and thus less politically damaging, decline in water demand after privatisation (for example, see Shiva, 2002). The financial burden remains directly upon poor individuals and poor communities, thus satisfying the neoliberal imperative arguing against wealth redistribution. But because the user fee is less of an immediate imposition on the poor, it is, so the argument runs, much less likely to be resisted. In India, Harper (2007b: 258) also reports that government officials are increasingly deflecting community demands for basic education and health services on the grounds that poor people '..now have microfinance' and should seek to purchase such services (albeit at high prices) from the private sector.

(d) 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. Most recently, commercial funding of microfinance programmes, including the outright purchase of established MFIs, 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 typical 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 2008/9, it was hoped that this 'public service function' would contribute to obtaining continued government and public support for the ongoing liberalisation of the financial sector.

(e) 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 government most of all (Gowan, 1999) – which 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; Chua, 2003; Collier, 2007). And unlike in the past when 'surplus' populations could be absorbed into expanding colonies and settlements, it is now a case that, as Seabrook (2007: 86) vividly argues, "there are no wildernesses left".

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 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 some issues of serious concern relating to the microfinance model. We agree that there are possibly some short-run benefits of microfinance. Principally this involves some quickly created income-generation opportunities for a small number of lucky individuals, as well as some more general consumption smoothing benefits for 'at-risk' groups. Into the medium to longer run, however, the picture becomes far less clear. Many of the supposed positive impacts we find to be quite illusory or, at the very least, hugely exaggerated. We find that microfinance in practise is actually more associated with adverse development trajectories, negative knock-on effects and major opportunity costs. All told, therefore, the microfinance model would appear to us to have very much less to recommend it as a development intervention than might at first appear. Put simply, the microfinance model appears to generate a set of 'initial conditions' that because of path dependency tend to give rise to a set of regressive local economic and social trajectories. It fails to adequately respond to the need to promote sustainable development, while it also blocks other development policies that might have more potential for sustainable impact given sufficient (similar) resources. Perhaps the microfinance model can therefore best be likened to a case of 'bad medicine' – it has created some temporary feel-good effects for both 'patients' (poor individuals, communities, countries) and 'doctors' (IFIs, microfinance institutions, the international development agencies) alike, but over the longer term it is likely that it has been gradually debilitating, not curing, the 'patient'.

So, finally, if the microfinance model is much less effective than it is widely claimed, if not an outright barrier to sustainable development, then two obvious questions arise. First: why is microfinance supported so strongly? We think we have provided at least part of the answer in section 3 above. 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.

A second, more practical, question to ask is this: are there much better local and national alternatives? We very much believe that there are, but fully adumbrating such alternatives would, of course, require another article (however, see Bateman, 2007b; Chang, 2007). But we can end on this. In terms of support for the most at-risk categories of individuals and communities, especially in the aftermath of disaster (conflict, natural disaster, factory closure, etc), then Brazilian-style 'Bolsa Familia' Conditional Cash Transfer (CCT) programmes have an excellent track record of getting small sums of cash to those most in need. Financial cooperatives and community development banks also stand out as impressive economic and social development instruments in even the most adverse circumstances. This has been particularly evident in northern Italy and northern Spain, where locally embedded financial cooperatives were capable of underpinning genuinely sustainable and equitable enterprise development (see Bateman, 2007b). Following the massive longer run success of carefully targeted subsidised micro- and SME loan programmes in post-war Italy and Japan (see Weiss, 1988; Friedman, 1988), there is surely significant scope for similar programmes today in many countries. More widely still, developing and transition economies should really look back to the financial policy measures extensively used by the now rich and richer countries (especially the

core EU and East Asian countries), such as credit cooperatives and specialized state banks, rather than to neoclassical textbook abstractions and neoliberal myths, and through a process of adaptation and experimentation locate for themselves the sort of poverty reduction and local development policies that will work the best.

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