Why Doesn't Microfinance Work?

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Background

- Muhammad Yunus started with microfinance in 1970s Bangladesh, funding the Grameen Bank in 1983
- International donor community, especially US government and World Bank, loved the idea and supported it wholeheartedly
- Idea took off globally, and microfinance became a hugely important anti-poverty policy
- Many subsequent awards offered, including Nobel Peace Prize in 2006
- Yunus widely recognised as a major pioneer in poverty alleviation and development

Commercialisation

- Then a problem emerges - the early institutions based on donor and government subsidies
- This contravenes the crucial ‘full cost recovery’ mantra at the heart of neoliberalism, and so also WB, IMF and USAID operations
- Solution found in commercialising the microfinance concept and turning it into a for-profit business
- Two key US institutions took the lead - Boston-based ACCION and the Harvard Institute for International Development (HIID)
- Two ideas uppermost:
  - Market-based interest rates to be used
  - Wall Street-style incentive structures deployed

Early results?

- Sheer simplicity of the idea convinces very many, so real impetus builds….
- Early impact evaluations by microfinance institutions and World Bank, USAID and others purport to show significant positive impact….
- Microfinance industry, advocates and friendly media publicise lots of individual heart-warming success stories, which convinces many that the concept surely ‘works’…..
- Also, the massive increase in the amount of microfinance is seen as an output in and of itself and so greatly celebrated – the poor will be ‘included’ and ‘financial democracy’ are silly phrases used here…

Early rumblings of problems

- The Bolivia microcredit industry crash in 1999 thanks to commercialisation-driven over-supply is first serious warning that the model is perhaps seriously flawed

- The problems surface in Andhra Pradesh in 2006, but state government told to ‘back off’…expansion of microcredit offer continues at 70% a year – total crash in 2010!!

- Pakistan, Morocco and Nicaragua then all experience commercialisation-driven collapse from 2008 onwards

- Bosnia since 2009 registering a major economic and social crisis thanks to microcredit – Bosnian government now increasingly sees it as a policy mistake

- Future meltdowns expected soon in Mexico, Peru, Cambodia and Azerbaijan…

- Major problem for the microcredit industry to explain is that, **all these economies show no signs of economic advancement thanks to lots of microcredit!!**

In fact, it all starts to go very seriously wrong…..

- Compartamos IPO in 2007 – reveals stratospheric profiteering by senior managers, but no evidence whatsoever of poverty reduction
- Randomised Control trials (RCTs) are supposedly more accurate, but show very little to no impact – major shock for supporters
- In fact, becomes clear there is **NO** real evidence that microcredit having an overall positive impact – only anecdotes (raising the ‘casino problem’)
- Two issues completely ignored – displacement and client failure
- Confirmed in 2011 by UK government-funded Duvendack et al’s systematic review that no identifiable impact in last 30 years of microfinance movement
- Duvendack et al show that all previous impact evaluations are seriously biased or methodologically suspect - most done by MFIs so understandable
- Conclusion of Duvendack et al? Support for microfinance was largely based on the politics not the economics……..

Why didn't we see the problems?

- For many years we have impact evaluations done by MFIs and their supporters (CGAP, USAID, ADB, DFID, etc)

- Lot of uplifting claims made for these evaluations, that they provide 'the evidence' that microcredit works – but all pretty much false!!

- Later so-called 'independent academics' make case for 'more accurate' Randomised Control Trial (RCT) methodologies

  – Karlan and Zinman in Manila
  – Banerjee, Duflo, Glennerster and Kinnan in Hyderabad

- Problem is these show very modest to no impact, so microfinance industry chooses to ignore them….

- Too much money being made! Investors in western countries making fantastic profits from microfinance in developing countries, so why rock the boat? See Hugh Sinclair's recent book 'Confessions of a Microfinance Heretic'

Common myths

- Some RCTs show ‘some’ benefits, so this is surely good for the local economy
- No – no real impact if no more ‘transformative’ than ‘dumpster diving’
- Some people clearly benefit, so this is good surely?
- No – in casino some do benefit, but they key fact is that on the whole the punters are made worse off…..
- Repayment is often very high, so this is surely good for the local economy?
- No – most often masks a number of profoundly anti-social dynamics, including asset sales by the poor, further indebtedness and unsustainable consumption spending.
- High interest rates have to be high because of high costs serving the poor?
- No – high interest rates are actually closely linked to the high financial rewards paid out to managers and owners of the MFI

The latest developments

- International development community has dropped all pretence of it being about ‘poverty reduction’ – have invented ‘universal financial inclusion’ as their new goal

- Yunus and other pioneers have also begun to drop microcredit and are now pushing ‘social businesses’, an idea likely to be an even worse intervention that microfinance!

- Many well-meaning agencies (Oxfam) have given up on microcredit and now push micro-savings….a little better, but still not a systemic solution to poverty in developing countries

- Even the Inter-American Development, a bastion of neoliberalism, has effectively abandoned microfinance, now claims that poverty in Latin America this last thirty years arose because of adverse financial intermediation process channelling funds into least productive enterprises – i.e., microenterprises!!

The alternatives?

- Community-based institutions, like credit unions started by trade unions and the poor to service their direct needs, NOT the financial sector
- Financial cooperatives as in Italy, supporting worker and other cooperatives into existence
- State development banks now back in fashion – Brazil's BNEDS is the role model, China too…
- New realisation that sustainable development is not about supporting the micro, but about other things like innovation, technology, training,
- and also – dare we say it - the conscious organisation of economic life (not just markets) - example is London Olympics! - as well as the distribution of power and wealth in society ……

Thanks for listening!

If any further queries, get me on

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