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Microfinance:

Myths and reality

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For about fifteen years, microfinance has been touted as an essential means of emerging from poverty by international institutions like the World Bank (WB) and the International Monetary Fund (IMF). According to Muhammad Yunus, the pioneer of microcredit, and winner of the Nobel Peace Prize in 2006, microcredit should relegate poverty to history.

From the 1990s onwards, the concept enjoyed real success in numerous developing countries in Asia, Latin America and Africa and today there are more than 3000 microcredit institutions.

Recent events have thrown another light on microfinance and its effects on poverty. In autumn 2010, a wave of suicides took place in the Indian state of Andhra Pradesh which has the highest rate of microfinance institutions in India. More than thirty people who had had recourse to microcredit killed themselves because they could no longer meet the repayments. A first wave of 200 suicides had already taken place in Andhra Pradesh in 2006 for the same reasons.

In Bangladesh, Muhammad Yunus and Sheikh Hasina Wajed, the Prime Minister, fought for control of the Grameen Bank, the main microfinance institution, founded in 1983 by Yunus. Yunus was dismissed from the bank despite a battle which had gone as far as the Supreme Court and despite the support the “banker of the poor” had received from powerful figures such as former WB president James Wolfensohn, Hillary Clinton and Nicolas Sarkozy, The image of microcredit seems durably damaged.

A brief history of microcredit

In the 1970s, Muhammad Yunus was an economist at the University of Chittagong. The great famine which struck Bangladesh in 1974-75 made him aware of the gulf which existed between the economic theories he taught and the reality lived by millions of Bangladeshis. Making contact with the inhabitants of Jobra, a village near Chittagong allowed him to “understand” that all these peasants were trapped in a vicious circle of poverty because they did not have sufficient funds to escape from it. A dollar could be enough to escape this infernal cycle but the peasants, excluded from the traditional banking system, were at the mercy of usurers whose loan terms ensured they sank still deeper into poverty.

Yunus then decided to lend to the poor and as the banks refused to grant credit, he made himself guarantor for the loans made. This experience could not however be realised on a wider scale, which led him to found a special bank for the poor in 1983. Thus the first microcredit financial institution, the Grameen Bank (“gram” means village in Bengali), was created.

The Grameen Bank

The site of the Grameen Bank [\[1\]](#), is indicative of the founding principles and functioning of microcredit.

The first principle affirms that credit is a human right. Nothing less. Thus the Grameen bank would fulfil a humanitarian mission by offering poor families, especially women, access to a universal right. Credit is issued so as

to allow self-enterprise (in the form of micro-enterprises) to generate income or to allow access to housing. It is specified that consumer credit is not covered.

To obtain credit, the borrower must join a group of "joint" borrowers. The loan is not based on a legal contract but on "confidence" with the bank and between the members of the group. Credit is obtained in parallel with a compulsory and voluntary programme of saving on the part of the borrowers.

In March 2011, the number of borrowers in Bangladesh reached 8.36 million, 97% of them women. The bank has 2,565 branches and works in 81,379 villages in Bangladesh. It employs 22,289 people. Since its creation, Grameen has spent the equivalent of 10.52 billion dollars in loans and 9.32 billion has been repaid. Between April 2010 and March 2011 the amount of loans came to 984.34 million dollars.

Since 1995, the Grameen Bank has no longer received private funds. It is 100% self-financed from its deposits. More than 55% of the deposits originate from the savings of borrowers themselves and the total amount of deposits represents 147% of loans. It is then the poor themselves who finance the loans.

All entrepreneurs on their own account

According to Yunus and the partisans of microcredit, poverty is not the result of exploitation but the exclusion of the most deprived from the capitalist system. "Poverty originates from the inability of workers to benefit from the fruits of their labour, because they do not control capital" 1. A little monetary impulsion would allow the world's millions of poor to transform themselves into entrepreneurs on their own account.

"What are needed are real structural changes so that the poor can have access to the market in the same way as the rich... Poverty can be eliminated, everywhere, without delay. It is solely a question of political will. We can only suppress poverty by giving the most deprived the means to themselves control their destiny. It is not work itself which eliminates poverty, but the capital derived from this work...Â " [2].

To sum up Yunus's philosophy, poverty can be eliminated by helping the poor become auto entrepreneurs, which all of us are in capability. The sole difference between a Bangladeshi woman and a company director is access to capital. So all those deprived of it should be allowed access to the market and the banking system.

A business on the back of the poor

The inadequacies of the banking system and the growing demand for credit from poor households has favoured the development of microcredit institutions. In India for example, the government estimated in 2005 the number of people excluded from the traditional banking system at nearly 300 million. It estimated also that 70% of the rural population had no deposit accounts, 87% had no access to banking credit and 55.1% of the poor borrowed informally (from family or friends).

The niche is very profitable. It is a business which allows making money on the back of the poor. Investment in a microfinance institution yields profitability on equity of around 20%. The rate of repayment of loans is more than 95%, but not because the poor are more honest than others and feel honour bound to repay their credit. Following the wave of suicides in Andhra Pradesh, the methods of microcredit institutions were highlighted and denounced.

Excessive rates stretching from 24% to 36% (but going as high as 75% as in the case of Compartamos Banco in Mexico); loan agents paid according to the number of clients, leading to insolvent persons borrowing; physical and mental harassment to recover unpaid debts, and so on.

An essentially neoliberal project

With microcredit, there is no contestation of the established order, no alternative to the capitalist model to struggle against poverty. Worse, the idea according to which “social aid distributed by numerous industrialised countries, including France, allows the deprived to survive, but not eradicate poverty” [3] reveals an essentially neoliberal project. At no time is it envisaged that the state could play a role in eradicating poverty. Microfinance invests where the state fails: for access to housing, care, the education of children.

The case of India is edifying from this viewpoint. Microfinance developed in the 1990s with the neoliberal turn. In the 1970s, the nationalised Indian banks had a quota of credits granted to rural areas as well as to small companies and to the most deprived persons. The Integrated Rural Development Programme (IRDP) was abandoned at the end of the 1980s and the liberalisation of the banking and financial sector opened the door to private intermediaries.

The promotion of “capitalism with a human face”

In parallel with microcredit the concept of “social business” has emerged.

In his book “Towards a new capitalism” Muhammad Yunus explains what he means by this: “A social business is a company which does not distribute dividends. It sells its products at prices which allow it to self finance. Its owners can recover the sum that they have invested in the company after a certain time but no share of the profit is paid to them in the form of dividends. Instead of that, the company profits remain internal to it so as to pay for its expansion, create new products or services, and do more good in the world” [4].

Social business is presented as a humanitarian and disinterested project. Big companies like Danone, big banks (CitiBank India for example) are very favourable to partnerships with companies which allow them to combine making money with a “social” profile.

In fact “social businesses” are social in name only. They operate on the same markets as other companies and are in competition with them. To survive, they must make a profit to be competitive. How then can they combine the search for profits with fulfilling a social mission?

If we look a little more closely, we see that these enterprises fulfil functions which should be the responsibility of the state and could be the subject of development of public services. Microfinance and “social” business develop because of the absence of the state as in Bangladesh or its withdrawal as in India in the late 1980s.

What effects on poverty?

According to Muhammad Yunus: “We are engaged in helping 100 million families to emerge from poverty through microcredit and other financial services.” [ibid.] What is the reality of this? In fact microcredit is rarely used by

borrowers to found a company. It is used in nearly 8 out of 10 cases for consumption, health, housing or education. This use does not generate any income allowing repayment for the loan, thus the indebtedness of poor borrowers increases.

Behind the “ethical” image of microfinance the picture is not very instructive. The principle of group solidarity increases the pressure on borrowers with each member of the group being responsible for the surety of the others. Not repaying means to cut off any new source of credit. As the families have access to several microcredit bodies, they borrow off one to repay the others A Ponzi spiral ensues.

Loans are aggressively offered to the poor without real checks as to their solvency. Interest rates are in the best of cases between 24 and 36%, a rate deemed acceptable by Yunus and the other promoters of microcredit. Increasingly enterprises associate a consumer product with the corresponding microcredit. Among NGOs it is not rare to associate the loan with products like mobile telephones, chickens and so on, by presenting them as products which could generate sources of income. In reality they create a dependency on the association. At the end of the day, microcredit favours the over-indebtedness, Ponzi schemes and dependency on financial bodies.

Several independent studies [5] have attempted to determine the real effects of microfinance in the fight against poverty. Two teams of researchers who worked respectively in India and the Philippines have based their study on the comparison of two populations, the one having access to microcredit and the other being refused it. The conclusions of the two studies converge, microcredit does not favour exit from poverty. In most cases, it allowed significant purchases of durable goods, but after having contracted a loan in the context of microcredit studies have shown that families abandon certain small pleasures (tea, snacks, tobacco, betel nuts and so on) to repay the loan which allowed them to buy the goods.

After 18 months no significant development in the lives of the borrowing families is noted. The more long term impact is in the process of being measured. Will the initial loan generate supplementary income? Will the repayments be too heavy? Watch this space.

Another study realised by a Bangladeshi economist working in the United States, Lamia Karim [6] sheds some new light. Surprised by the excessively high rate of recovery of loans, this economist made an investigation on the ground in 1997 then returned in 2007 to continue his study. Rejecting the discourse according to which there would be a natural correlation between poverty and honesty, Karim highlighted a much more sordid reality which he calls the “shame economy”.

The study shows that 95% of the requests are made by the husband or son of the family. The extension of the loans to Bangladeshi women could have very unfavourable consequences for them. The microfinance bodies in fact exploit the social code of honour and shame in force in Bangladesh, women being the guarantors of family honour. As women are held responsible in case of non repayment, the recovery agents don't hesitate to humiliate them publicly to obtain repayment of the unpaid instalments.

What alternatives?

Independent studies help to demystify the slick speeches on microcredit while the waves of suicides that took place in Andhra Pradesh illustrate that its affects can be dramatically negative. Recent experiences of struggle against poverty in countries like Mexico or Brazil have involved a transfer of income with counterparts. The “Oportunidades” programmes begun in Mexico in 1997 or the “Bolsa Familia” launched in Brazil in the last decade involve giving poor families small sums of money in exchange for the regular school attendance for children and a

monitoring of their health. These policies have cost little in terms of GDP, around 0.4 or 0.5 % in the case of Brazil. They have thus not had a negative impact on growth as it too often affirmed by those who advocate orthodox policies to control inflation and reduce public debt.

The results of these income transfer policies are however controversial. According to the most favourable evaluations [[“Favelous”. The Economist.](#)]] *Bolsa Familia would have reduced poverty by 17% since 2001 and had a positive impact on the reduction of child labour and child poverty in the countryside [[7](#)].*

But these policies of income transfer with counterparts as well as microcredit do not attack the roots of poverty: the absence of jobs or low wages which keep the poor in poverty. Microcredit is in no case an instrument which would create the tens of millions of jobs necessary in a country like Brazil.

Other instruments for redistribution of income, less popularized than “Bolsa Familia” or microcredit, have been implemented, notably the increase of the minimum wage and access to equal pensions at a minimum wage for handicapped persons over 65 and the poorest peasants. These measures are more effective in terms of the breadth of poverty, while instruments such as Oportunidades or Bolsa Familia only attack it at its depth [[8](#)]

Contrary to the affirmations of neoliberal thinkers, the state should remain or become an instrument for the reduction of poverty. It should develop social policies or public services to satisfy social needs, notably education and health. It should implement policies favourable to employment and higher wages. These policies should be financed by progressive taxation on the wealthiest and a tax on financial transactions.

[1] <http://www.grameen-info.org/>

[2] “Transgresser les préjugés économiques”, Muhammad Yunus, “Le Monde Diplomatique”, December 1997

[3] *ibid.*

[4] from the article “Muhammad Yunus : Prix Nobel de l’ambiguïté ou du cynisme?” Denise Comane – CADTM

[5] “The Miracle of Microfinance? Evidence from a Randomised Evaluation”. Abhijit Banerjee, Esther Duflo, Rachel Glennester and Cynthia Kinnan, May 2009. “Expanding Microenterprise Credit Access: Using Randomized Supply Decisions to Estimate the Impact in Manila”. Dean Karlan and Jonathan Zinman, July 2009

[6] Jacquemont Stéphanie. “Les promesses non tenues du microcredit: nouvelles preuves à charge”
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[7] “How to get Children out of job and into school”. The Economist. <http://www.economist.com/node/16690887>

[8] Salama Pierre. “Lutte contre la pauvreté en Amérique latine”.
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