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From Zorro to Zombie: the rise and fall of the microcredit movement

By Milford Bateman

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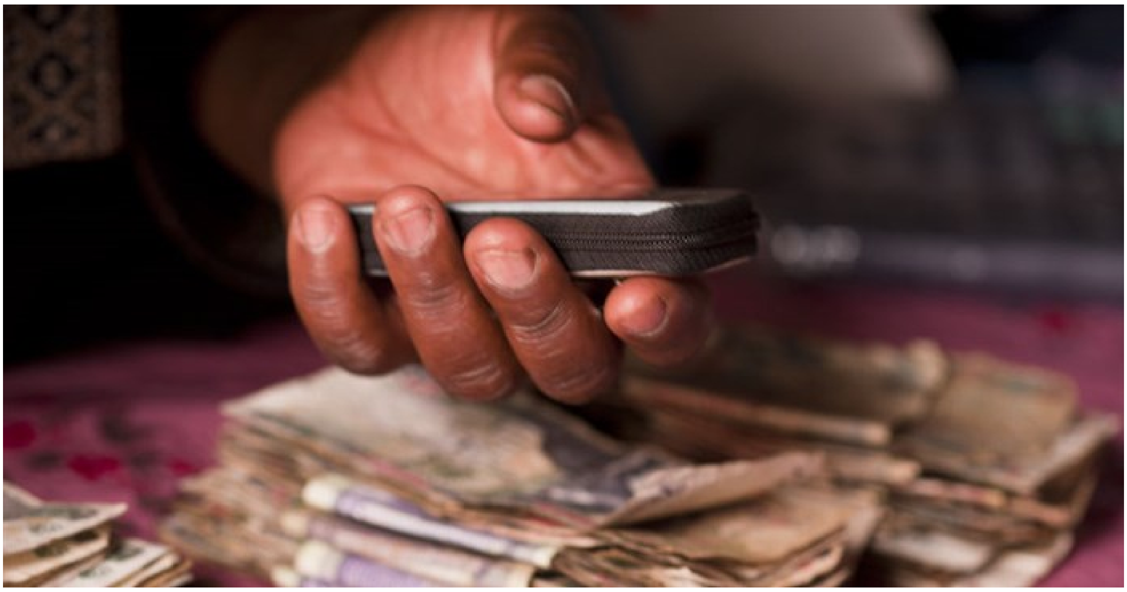
Thirty years ago, the international development community was in a state of high excitement. The perfect market-affirming solution to poverty in developing countries had apparently been found. Microcredit, also known as microfinance. This involved giving micro-loans to the poor that allowed them to establish a range of very simple self-employment ventures that would generate income.



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Spearheading the concept was the US-educated Bangladeshi economist and future Nobel Peace Prize winner, Dr Muhammad Yunus. Yunus portrayed microcredit as a panacea for a range of development ills. He said it would rapidly eradicate endemic poverty and under-development by creating jobs, raising incomes and including previously excluded groups (notably women) into economic activity.

His laudable objective would be reached by bringing capitalism down to the poor.

With significant funding, especially from aid agencies and private foundations based in the US, Yunus was able to establish his own "bank for the poor", the iconic Grameen Bank.

The birth of hundreds of Grameen clones

The Grameen Bank was quickly positioned as the "role model" financial institution for poverty reduction. It was then joined by international donor-financed "Grameen clones" across all developing countries. Yunus had effectively given birth to the global microcredit movement.

Not surprisingly, for the neoliberal-oriented World Bank and USAID, the ideological case for microcredit was compelling. Microcredit resonated with their fixation on promoting self-help, individual entrepreneurship and market forces as the only way that the poor would escape poverty.

With their help, the microcredit movement quickly elevated the supposed poverty reducing power of self-help and individual entrepreneurship to almost miracle status. To escape poverty, the poor no longer needed state intervention and other forms of "collective capability" such as trade unions, public ownership and strong regulations.

Only one last hurdle had to be overcome before the global triumph of microcredit. A core aspect of the new neoliberal agenda was its emphasis on the need for all institutions in society to be financially self-sufficient and profit oriented. Subsidies and public investment were bad words.

The heavily subsidised Grameen Bank-style microcredit industry clearly could not survive under the new neoliberal "self-sufficiency" paradigm. Led by USAID and the World Bank, the microcredit model was therefore extensively commercialised, privatised and liberalised.

It was essentially developed into a for-profit private business model. Microcredit was turned into a business, but one imbued with a crucial social goal - poverty reduction. With this important change secured, the microcredit industry began a very rapid expansion.

By the mid-2000s the model was being described as the most effective anti-poverty and "bottom-up" development intervention of all time. With support from both the left and the right of the political spectrum, the UN agreed to nominate 2005 as the UN Year of Microcredit.

And then it all began to go horribly wrong.

Foundations of sand

The agreed catalyst for the rapid collapse in the legitimacy of the microcredit model was the Initial Public Offering in 2007 of Mexico's largest microcredit bank, Banco Compartamos. This event exposed something quite shocking - a spectacular level of profiteering by senior managers and outside investors, yet no evidence of any reduction in poverty among its poor clients.

This scandal proved to be the tip of the iceberg. It soon became clear that the microcredit model had effectively been taken over by greedy "social entrepreneurs", aggressive private banks and hard-nosed investors.

With the door now open for genuinely balanced assessments of the microcredit model, the veracity of the accumulated evidence base justifying the concept was soon being challenged. It was quickly exposed as fundamentally flawed.

Such was the fragility and weakness of the evidence that one major UK government-financed study concluded that the entire microcredit movement had effectively been constructed on "foundations of sand".

Even worse, a number of spectacularly destructive 'boom-to-bust' episodes began to break out in countries and regions where microcredit had reached critical mass. The legitimacy of the microcredit model as a poverty reduction instrument was effectively destroyed.

In little more than 30 years, the microcredit concept had gone from being equated with Zorro, the mythical Mexican hero and friend of the poor and exploited, to being widely referred to as a Zombie policy. In other words a dead and rotten idea that nevertheless keeps rising from the grave to lumber into the village to terrorise the local population.

How did it come to this?

The modern microcredit movement was actually founded on a very fundamental misunderstanding. Yunus' uplifting claims were based on a far-reaching, and wrong, assumption. This was that the poor, especially women, could easily establish an informal microenterprise selling simple items and services to other poor individuals in the same community.

Yunus's firm opinion was that so long as the poor could be helped to produce something, they could easily sell it. As he famously put it:

> *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.*

Unfortunately, Yunus had erred big-time on this. He had actually fallen victim to a long-disproved fallacy in economic history known as Says Law. This is the mistaken idea that "supply creates its own demand.

As the late political economist Alice Amsden brilliantly explained, the core problem in developing countries is not the supply of the simple items that the poor need to survive. Rather it is the sheer lack of local demand, or purchasing power, required to actually buy needed items - including food - and services.

Even in the very poorest communities there are always enough retail stores which the poor can access to get what they need to survive. But only if they have sufficient financial resources to do so. The problem is thus not a lack of supply, which microcredit can easily resolve, but a problem of a lack of demand caused by the low incomes of the poor. This requires a much larger response than mere microcredit.

Another important indicator of the failure of microcredit is that poor people no longer choose to access micro loans to invest in an income-generating enterprise. Most know two things: they will either struggle to generate sufficient income to repay the loan, or the enterprise will fail very quickly. Not surprisingly, a growing number use microcredit simply to ensure their everyday survival.

The hope is to eventually repay the loan. But in practice, they increasingly take out larger and larger microloans, and very often more than one, simply to survive. In some cases, new microloans are taken merely to repay instalments due on previous loans.

As a result, individual over-indebtedness in a growing number of developing countries has begun to reach quite staggering levels.

The global microcredit industry has achieved nothing more for the mass of clients than to plunge them into deep debt and irretrievable poverty. This was perhaps not the original intention of those promoting microcredit, but it is what has happened nevertheless.

This is part of a series The Conversation Africa is running on financial inclusion and micro credit and their role in economic development.

ABOUT THE AUTHOR

Milford Bateman is Visiting Professor of Economics, Juraj Dobrila University of Pula, Croatia.