Part I: Thinking Development through Finance

"Our dream is a world free of poverty. […] And I really think we're not going to eradicate poverty unless we have financial inclusion […] You have good finance, bad finance, and ugly finance. You need to make sure it serves citizens, the SMEs [small and medium-sized enterprises], and not just the banker, or the wealthy, or the chosen few"
– Ceyla Pazarbasioglu, Vice-President, Equitable Growth, Finance and Institutions (EFI), World Bank Group (Politi 2019)

"Five years ago, we didn't have money, so we never even thought of going to a bank. We still don't have money. So what will we do there now?"
– Mukhne, Adivasi woman, daily wage labourer in agriculture (Abraham 2019)

Chapter 1
Boom and Bust: A Very Brief History of Modern Microfinance

This part summarises the evolution of microfinance as a development policy in the context of the global political economy, explicitly highlighting continuities and changes in the shift towards financial inclusion. It thereby provides an essential context for the following investigation. To engage with the periodisation of microfinance initiatives, I draw on Gillian Hart's (2010) proposition to understand Development ('big D') and capitalist development ('little d') as different though interconnected processes. Development refers to a bundle of interventionist institutions that have begun to work on the growth-poverty nexus in the Third World in the context of a fundamental crisis of Western imperialism in the first half of the twentieth century, most prominently marked by decolonisation struggles and the Cold War (Escobar 1999; see also Esteva 2010; McMichael 2017, 40ff.). In contrast, 'little d' comprises the uneven process of destruction and creation that underpins global capital accumulation, requiring and calling forth ongoing interventions to grapple with the permanent production of contradictions (Hart 2010, 119).

Importantly, from this perspective, the role of Development institutions, like the World Bank or International Monetary Fund (IMF), is not understood as a functionalist necessity to solve the contradictions of global capital accumulation. Rather, Development operates unwillingly on the background conditions of uneven capitalist development, working through its contradictions and reproducing them in new and mutated ways (Taylor 2005, 154). As such, this framing allows an understanding of microfinance's evolution as part of a broader process of thinking and practising D/development through finance since the 1970s.

Talk of financial inclusion as an explicit concept and development strategy has been a relatively recent phenomenon since the late 2000s. However, the notion closely ties with microcredit's international rise and promotion since the 1970s. Thus, the following chapter will briefly review the history of microfinance before discussing the political, economic, and ideational context in which financial inclusion emerged and transformed development policies.

Finance and Development in a Post-Colonial Context

In the aftermath of the third wave of decolonisation in the 1960s, Development was primarily understood as fostering economic growth and mobilising resources for industrialisation. For post-colonial societies dominated by agricultural production, the central challenge was to enhance productivity, most prominently fostered by the Green Revolution, and accumulate capital that could be invested in emerging industries (McMichael 2017, 73ff.). In this regard, the role of a developmental state, coordinating economic activities and allocating credit, was seen as a crucial precondition for successful industrialisation and improving living standards (Kohli 2004; Shah, Rao, and Shankar 2007; Williams 2014). The creation of roughly 550 public development finance institutions (DFI) worldwide in the second half of the twentieth century boosted economic growth through targeted investment in agriculture and other priority sectors (Bruck 1998).

However, criticism of targeted and subsidised access to credit through public banks and DFIs cumulated in the early 1970s. Misallocation, moral hazard problems, enormous costs weighing heavy on government budgets, and crowding-out of private credit suppliers were major arguments from economists calling for a more liberalised, market-oriented credit facilitation structure with a more prominent role for private corporations (Braverman and Guasch 1986; Calomiris and Himmelberg 1994; McGuire and Conroy 2000).[1] In line with a general shift in academia, particularly pronounced in the domain of economics, the central role of governments as economic actors became increasingly controversial, and macroeconomic policies prescribing a significant role to the state lost credibility. Instead, neoliberal thought advocating "free market economics" swept university departments, development institutions and policymakers across the world (Harvey 2005; Milonakis and Fine 2009; Mirowski and Plehwe 2009). Accordingly, many of the development banks and other state-owned enterprises that mushroomed in the context of the nascent post-colonial era were privatised, restructured or liquidated, and public 'divestment' made room for new private actors (Bruck 1998; Cowan 1985).[2]

This ideological shift was paralleled by fundamental changes in the world economy, particularly the international financial system. US president Nixon's decision to unilaterally cancel the direct international convertibility of the US dollar to gold in 1971 ushered in the abrupt end of the Bretton Woods System and signalled the rapid

1 For a critical account of how "moral hazard" has evolved from an economics concept to become "a part of mainstream development thinking, traveling across the world through diverse networks of think tanks, NGOs, and financial institutions", see Young (2010b).

2 Ironically, "the pervasive role of the state in economic development in the Third World stemmed in part from the pre-independence period in which the colonial administrations controlled the direction and rate of economic change" (Cowan 1985, 47). See also Chapter 10.

rise of financial markets, including new products, actors and regulations (Harvey 2005, 12ff.; Helleiner 1994; McNally 2011a, 85ff.). In this context, many newly independent countries in the South were flooded with foreign capital from North Atlantic banks which had accumulated gigantic surpluses during the oil price hikes in the early 1970s (the so-called *Petro-Dollar-Recycling*).[3] External debt of Third World states (particularly of non-OPEC countries) exploded from US$ 47.5 billion in 1968 to US$ 560 billion in 1980 (McNally 2011a, 98). Vijay Prashad argues that loans to these countries were "the international sub-prime market" of the day since credit was given without care for the borrower's solvency (Prashad 2012, 50).

When Paul Volcker, Chairman of the Federal Reserve, raised interest rates to 20 per cent to fight domestic inflation in March 1980, most borrower countries struggled to repay the rising interest rates, despite repaying billions of dollars. Twenty-four of these had to reschedule or refinance their sovereign loans between 1982 and 1984, with large US banks like Chase Manhattan, Bank of America and Citibank as their creditors. Because no formal international solvency mechanism was in place, the International Monetary Fund (IMF), the World Bank, and the US government created an *ad-hoc* regime, famously known as the Washington Consensus: The IMF and World Bank set up a number of short and medium-term loans to refinance the credit owed to large commercial banks based on the conditionality that debtor countries implemented cuts in public budgets, privatised public sector firms, deregulated utilities, desiccated social service provision (health, education, and agricultural subsidies), and introduced financial liberalisation (McMichael 2017, 114ff.; Prashad 2012, 58). In effect, the informal arrangements of transnational debt negotiations[4] helped to augment the power of credit to serve as an effective form of social discipline, allowing donor states and capital "to coerce debtor states into accepting, implementing and internalising neoliberal policies" (see also McNally 2011a, 135ff.; Soederberg 2005, 928).

The bitter irony of this historical context is that access to finance, for governments, not households, in the global South had become one of the most contested

3 Chandrashekhar and Ghosh (2002, 12) maintain that OPEC countries had accumulated US$ 475 billion by 1981, of which US$ 400 billion were parked with financial institutions in the global North. Many US and European corporations faced dismal conditions at the time, struggling to revive profitability in a stagnating economic atmosphere, and thus not in demand for such massive credits.

4 This refers to the arrangements of the Paris and London Club as well as the surveillance duties of the International Monetary Fund (IMF) that came into place in 1977. The proposal of the United Nations Conference on Trade and Development (UNCTAD) and the G-77 to create a permanent body called International Debt Commission (IDC), that would deal with the rescheduling and refinancing of Third World debt, was resisted by donor countries because these governments did not want to treat debt as *political* (Prashad 2012, 54; Soederberg 2005, 935).

issues of international politics in the 1980s. As Sarah Bracking notes in her reflection on the structural adjustment programmes (SAPs), "[w]hole countries are seen as unworthy 'too risky' and are then, on the basis of this decision, denied the necessary means with which to build a better future" (Bracking 1999, 208). Moreover, the macro-debts of states and the micro-debts of households were intimately linked. Most SAPs featured the same policies, including the re-structuring of public expenditure priorities (e.g. cutting subsidies for farmers or reducing expenditure for welfare measures), tight fiscal discipline to prevent new public investment programmes, tax reforms to attract foreign direct investment (FDI), privatisation of nationalised industries and services amongst others, and trade liberalisation (e.g. mass imports of food from the West).[5] Consequently, structural adjustment had not only meant a considerable wealth transfer from "so-called developing nations for banks in the North" (McNally 2011a, 132). It also eroded the emerging middle-classes – most notably in Latin America – through the spread of unemployment and poverty (George 1990, 64f.), fostered the destruction of subsistence economies through a new wave of enclosing the commons, and generally increased the market-dependent social reproduction of the masses in the global South (Federici 2012, 101ff.; McMichael 2017, 116ff.).

In a context of a dramatic balance of payments and debt crises of many countries in the Southern Hemisphere, the policy space for governments to tackle surging unemployment and social and economic immiseration was limited. Congruent with the trends of growing beliefs in the power of markets, development thinkers started to emphasise income-generation through self-employment as an alternative. Rather than promoting job creation in the formal sector, the poor might work out of poverty through self-employment (McGuire and Conroy 2000). In the wake of the deteriorating livelihoods of significant shares of populations in structurally adjusted countries, microfinance emerged as a viable strategy pushed by development institutions.

Experimenting with Microcredit

The consequences of the new international financial architecture not only influenced those countries directly affected by the debt crisis of the 1980s. For example, an OPEC member, Indonesia, profited from high oil prices in the 1970s, translating into vibrant economic growth. With declining oil prices and respective effects on the domestic economy in the early 1980s, the country embarked on a path of

5 A survey of IMF loan conditionalities across 130 countries, mostly in Asia, Africa and Latin America, between 1985 and 2014 finds little evidence of transformative changes over time (Kentikelenis, Stubbs, and King 2016).

neoliberal "shock doctrine" under the military dictator Suharto to revive economic growth (Klein 2007, 68f.). As part of this shift, experiments with modern microcredit started in Indonesia. The country's oldest and largest commercial bank was transformed from a loss-producing state-owned financial institution "into the most profitable bank with the largest micro banking network in Indonesia" (Seibel and Ozaki 2009). Since the 1950s, Bank Rakyat Indonesia (BRI) has provided targeted credit, for example, to foster the Green Revolution in agriculture. During the 1980s, the bank's units were re-structured according to profitability, including incentives for management and staff that would perform well, penalties for those who would perform below specific benchmarks, and incentives for customers for timely repayment of loans. Henceforth savings were mobilised in villages nationwide, while loan disbursement was oriented toward profitability. BRI diversified its credit products and now offers a gradual ladder of (micro-)loans to every creditworthy customer for both income-generating activities and consumption loans. The transformation from targeted to market-based credit was a financial success. By the end of the 1980s, BRI had become economically self-sufficient and independent from the government funds (which provided the initial capital) and from further liquidity assistance provided by the World Bank (Seibel and Ozaki 2009). Like many microcredit experiments, BRI's transformation was celebrated as a significant achievement on the road to eliminating poverty. Although the bank reached roughly one-fourth of the country's households, the proliferation of microcredit might not be associated with substantial poverty alleviation. When the bank began its new course in the mid-1980s, the "reported incidence of poverty nationwide had already fallen from 60 to just over 20 per cent" (Henley 2010, 184).

The international political and economic context is also essential for the most potent narrative of the emergence of modern microfinance, namely that of Grameen Bank in Bangladesh. Most microfinance accounts celebrate Muhammad Yunus as the founding father of contemporary microcredit. Driven by his encounters with the poverty-ridden villagers of Jobra, close to the campus of the University of Chittagong, where he read economics, Yunus started to advance small amounts of cash to artisans and businesswomen. He was a guarantor for their loans with a local bank branch in the mid-1970s before eventually founding the Grameen Bank (literally: village bank). His mission was to provide an alternative to local moneylenders that demanded absurdly high-interest rates and to ameliorate the immiseration caused by the 1974 Bangladesh famine (Yunus and Jolis 1998). Despite his recognition that poverty is rarely caused by the poor themselves but rather by the circumstances surrounding them, neither Yunus nor microfinance enthusiasts explore the context of the devastating famine.

While the immediate causes of the 'man-made famine' are to be found in the hoarding and speculation of grain producers and traders, as well as a series of bad harvests in the early 1970s, and the consequences of the liberation war and devastating floods in the Monsoon season of 1974, the international political economy also shaped the dramatic episode of the newly independent country in crucial ways. To reverse the trend of rising oil prices in the 1970s, the US government used the dependency of developing countries like Bangladesh on food aid to exercise leverage on OPEC to reduce prices.[6] Eventually, this pressure destabilised Bangladesh's food import regime and the local public distribution system, failing to assist those in need (Sobhan 1979).[7] Under these circumstances, modern microfinance was 'invented' by Yunus as a strategy to alleviate the poverty of the rural population, which had been exacerbated due to the famine. The idea of lending small amounts of money to peasants, small artisans, business people or even labourers was not entirely new (see e.g. Armendáriz and Morduch 2010, 67ff.). But Yunus 'invention' was based on three novel characteristics.

First, his Grameen Bank approach pioneered group lending based on peer pressure. While cooperatives or credit associations are usually also governed by their members, the new microcredit system was controlled by so-called banks for the poor (often non-governmental organisations), which relied on the joint liability of borrowers to ensure repayment on time. Although many initial operations were not premised on profit, the group-lending model showcased how lending to the poor can become financially viable and thus appealed to the international financial community. Second, lending occurred almost exclusively to women, arguing that they have better repayment morale and would generally use credit more beneficially for the household's welfare. This aspect dovetailed with a mainstreaming of gender equality and women's empowerment in international development that already started in the 1980s and became institutionalised in the mid-1990s (Kabeer 2001; Walby 2005; Weber 2014). Third, microcredit was linked to a strong notion of the entrepreneurial spirits of poor women, resonating with the above-described shifts in intellectual currents, building on the omnipresence of self-employment in the informal economy and complementing state-led welfare programmes by engaging the 'social capital' of the poor (Harris 2001; Rankin 2002).

The microcredit approach of Yunus and the Grameen Bank appealed to the international development and business community because it had an essential liberal, pro-business and market-oriented narrative to offer while adding an ethical dimension. Importantly, however, these early experiments with microcredit were still primarily financed through public money, mainly through development departments from OECD countries and respective national and multilateral development banks.

6 This included both pressures on food procurement and on the balance of payments of non-OPEC developing countries in order to divide the ambitions of a new international economic order of Third World countries (Sobhan 1979).

7 For a more detailed popular exploration of the entitlement failure in the Bangladesh famine of 1974, see Sen (1981).

The Grameen Model was not replicated with all its features throughout the world. Nonetheless, it served as a blueprint of how microfinance worked, legitimising different loan programmes targeting 'the poor'. BancoSol is perhaps one of the most prominent examples.[8] The bank had emerged from PRODEM, a Bolivian non-government organisation established by the American organisation ACCION and with substantial financial support from USAID and Bolivian businessman and former Finance Minister Fernando Romero. It adopted the joint liability principle, borrowing to individuals in solidarity groups of up to eight individuals, whilst a group member can only receive a credit if no other member is in default. The microcredit experiment, mainly targeting urban dwellers, many of whom had been struck by the austerity measures from the SAPs, quickly grew and eventually was the first NGO providing microloans that turned into a commercial bank (BancoSol) in 1992 (Mosley 2001).

This brief review may show how microcredit experiments emerged as a Development approach ('big D') to entrenched poverty in the context of a broader crisis of global capital accumulation, particularly the Third World Debt crisis and the consequences of structural adjustments. The latter must be understood as part of the neoliberal counter-revolution against calls to decolonise and democratise the international political and economic order ('small d'). Official development aid (ODA) maintained this first wave's NGOs and government initiatives since the 1970s. In this regard, Hulme and Mosley's widely recognised study *Finance against Poverty* argued that there must not be a trade-off between poverty alleviation and economic growth in the context of structural adjustment since lending to the working poor reduces poverty and has still proven to be financially viable (Hulme and Mosley 1996, 207). NGOs, public development banks and parastatal bodies were encouraged to adopt private-sector management techniques to prove economically sound. However, for neoliberal market radicals, this was not enough.

From Villages to Washington…to Crisis

In the 1990s, the early microcredit experiments were increasingly criticised by radical proponents of financial liberalisation and market efficiency who denounced these approaches as 'poverty lending'. In contrast, the 'financial systems' approach emphasised the need to entangle emerging microcredit with the growth of financial markets (Rhyne and Otero 2006; Robinson 2001). Essentially it aspired to "a level of

8 Other examples include the funding of the Kenya Rural Enterprise Programme (K-REP) through the British Department for International Development (DFID) or the Self-Employed Women's Association (SEWA) in India through the World Bank, International Labour Organisation, and German development bank KfW.

compatibility" between finance and development as two distinct "ways of thinking" by integrating the rise of microfinance as development policy within the logic and structure of financial markets (Otero 2000, 16). Most importantly, informal sources of credit and finance had to be formalised and controlled by private institutions (NGOs or corporations), which could then access capital markets to fund their lending portfolio, dramatically scaling up their businesses (Otero and Ryhne 1994).

The focus on microloans as a primary strategy to tackle the growth-poverty nexus also fitted the Post-Washington Consensus (PWC) and its emphasis on getting institutions right (Johnson 2009, 293). Consequently, donors and multilateral organisations endorsed the slogan "making markets work (better) for poor people" (World Bank, 2001, p. 61ff.). Consistent with this motto, finance and development consultants increasingly pushed the financial systems approach, "making *financial* markets work for the poor" and constructing low-income households across the globe as a new market frontier (Porteous 2004; Robinson 2001). Although the agenda emphasised the role of private actors as more efficient and custom-made service providers, governments were still crucial for providing adequate infrastructure and facilitating access to populations previously out of reach of the financial system (Otero 2000).

The World Bank has been particularly relevant in promoting and disseminating the "microfinance revolution" (Robinson 2001). As Ananya Roy notes in her critically acclaimed work on microfinance:

> "Indeed, it is the World Bank that controls the portals of knowledge, establishing the norms, metrics, rankings, and best practices of microfinance. World Bank training workshops, texts, and reports disseminate such authoritative knowledge, investing some experts with the authority to be microfinance experts and denying others legitimacy and significance. In short, what is at work is a "Washington consensus on poverty." (Roy 2010, 5)

Key to the institutional mainstreaming of microfinance was creating a global platform named the Consultative Group to Assist the Poorest (CGAP), an in-house organisation of the World Bank. Today's 30 members include ministries of foreign affairs and development of most significant OECD countries, development banks such as the African Development Bank and the KfW Bank Group, philanthropic foundations such as the Bill & Melinda Gates Foundation (BMGF), and corporate financial players like Credit Suisse. These agencies have pledged resources to support sustainable microfinance per best practice principles agreed upon by the group. Since its inception, a significant share of the CGAP's donor budget has come from private entities, including the Bill & Melinda Gates Foundation, the Mastercard Foundation, the Omidyar Network and Citi Foundation. The CGAP and its members quickly adopted the financial systems approach as the only reasonable way to promote access to credit for low-income households.

To institutionalise microfinance as a top development policy, the Microcredit Summit Campaign launched a major international conference in February 1997 in Washington, DC. Almost 3,000 delegates from more than 130 countries convened to discuss the potentials and challenges of microcredit, commencing a decade-long campaign with annual summits to boost the new instrument. According to the campaign, the global customer base had grown from 13 million in 1997 to 211 million in 2013 (Reed et al. 2015). Without any doubt, by the turn of the millennium, microcredit had emerged as the "most innovative strategy to address the problems of global poverty", as the editors of the newly founded *Journal of Microfinance* put it in their opening statement to the journal's first volume (Woodworth & Woller 1999).

However, microfinance had fallen into disgrace by the end of the 2000s among many journalists, academics and former practitioners. Influential media outlets in the US and Europe, including *The Washington Post*, *The Atlantic*, *The Guardian*, *Frankfurter Allgemeine*, and many others, all featured lengthy essays and background articles demystifying the microcredit hype, blaming the new development ideology for having fostered indebtedness and further despair amongst the world's poor (Hein and Bernau 2011; Provost 2012; Roodman 2012; Toyama 2011). In a contribution to the *New York Times*, Muhammed Yunus confessed a "mission shift" in which microfinance has essentially become dominated by the profit-motive: "In 1983, I founded Grameen Bank to provide small loans that people, especially poor women, could use to bring themselves out of poverty. At that time, I never imagined that one day microcredit would give rise to its own breed of loan sharks" (Yunus 2011). Like Hugh Sinclair, former microfinance employees started to speak out on the microfinance sector's corrupted, coercive, and ethically questionable sides (Sinclair 2012). Roy (2010) reports from several senior advisors and staff members of the CGAP (between 2004 and 2008) who reflected on microfinance's limits and admitted that only little empirical evidence indicated that microfinance was either sustainable or reducing poverty.

The burgeoning scepticism was not only based on newspaper and insider reports. Increasingly, economists questioned the rigorousness of used methodologies and inadequate data, reviewing impact evaluations and claiming that there was no sound evidence that microfinance worked (Armendáriz and Morduch 2010; Banerjee et al. 2009; Duvendack et al. 2011; Hermes and Lensink 2011). These insights also widened attention to a more fundamental questioning of the kind of development logic microfinance promotes (Bateman 2010; Guérin, Labie, and Servet 2015; Karim 2011). Moreover, several regional crises from Nicaragua and Bosnia-Herzegovina to Morocco and Pakistan hit the microcredit sector in the late 2000s (Mader 2015, 68f.). Shortly after the US subprime crisis and the ensuing global slump, critical scholars referred to the major microcredit crisis in the Indian state of Andhra Pradesh as "the other financial crisis" where about 82 per cent of rural households were indebted in 2010, most of them juggling with three or more loans at a time (Taylor 2012; Wichterich 2012).

Despite microcredit remaining essential to the international development community, the discourse shifted around the recent financial crisis. However, this change has not marginalised microfinance's role but instead exacerbated it as part of a broader strategy. Alok Prasad, former chief executive of India's Microfinance Network, sums up the paradigm shift in a recent interview with the *Financial Times*: "That rosy view we have of microfinance is over [...]. The terminology has [also] moved on from 'microfinance' to 'access to finance'" (Kazim 2018).