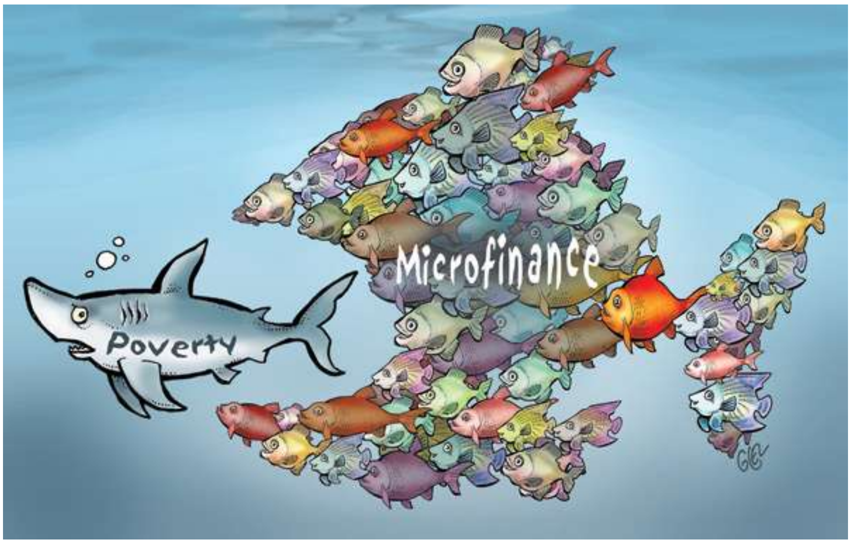
Micro-Finance : a source of Development? | By Chloe Phitoussi.



In 2007, the Consultative Group to Assist the Poor (CGAP)wrote a detailed paper on the controversies surrounding the IPO, or Initial Public Offering, of the Mexican microfinance bank Compartamos ("let's share" in Spanish). The paper not only details the banks history, from its foundation as a small non for profit in 1990 to its introduction into global markets in 2007, it also raises interesting questions on the seemingly paradoxical association of capitalist theories and social work that is microfinance.

In theory, microfinance combines both in an effort to help the world's poor lift themselves out of poverty; microloans allow for small business growth, which in turn stimulates a developing country's economy. A microfinance institution's focus on social work — an MFI is owned and run by its members— is meant to help the community in which it is located become prosperous. The MFI does so by not only helping its members financially, but also by offering entrepreneurial advice and spearheading social projects. In fact, however, microfinance, even by its very definition as a bank offering entrepreneurial loans, encourages competition between a country's poor and promotes a survival of the fittest attitude that goes hand in hand with capitalism.

Why then is it so surprising to some that a bank such as Compartamos should assume the capitalist aspect of microfinance to its fullest? Will the bank not, in this way, acquire money that an MFI focusing mainly on its social work cannot, and in turn use it to fulfill its perhaps less significant but nonetheless existent social goals, such as eliminating poverty?

The CGAP's paper reveals that the answers to these questions are not so simple. Compartamos, for one, did not create and sell new shares during its IPO, a move that would have brought funding to the bank. Instead the money made, nearing 400 million dollars (no small sum for an originally non governmental, non profit organization), went to shareholders who were selling off part of the existing shares they held in the bank. This goes to show how even when given the opportunity to use capitalism in a way to help the poor, microfinance institutions may choose to completely ignore their social goals.

What is more, is has since been discovered that one of Compartamos' success stories, that of Eva Yanet Hernández Caballer, is not as much of a success story as the bank would like to have us believe. Hernández started taking out loans from Compartamos in 2001. With these loans, she was able to expand her sock making business. Her and her family of six even made up to $800 a week at their peak. This is where the story Compartamos tells stops. But Hernández' story continues: the bank's high interest rates eventually pushed her to default on her payments. She now makes $270 a week.

The major problems the paper raises is therefore the following: is it possible to combine humanitarian and social work with capitalist ideologies by which winners will necessarily be created to the detriment of others? Is it not better to either focus solely on humanitarian work in its most rudimentary form, or let market forces play out without risking the hypocrisy of claiming to help the poor? Most importantly perhaps, is it realistic to believe that a market economy can allow for social justice, and is it 'fair' to impose such a model to other countries as the only road to 'success?'

Microfinance, which has had an exponential growth throughout the developing world mainly, has come to embody, for some, the western countries' attempt to export capitalism. This is not necessarily false. Nor is it bad. If western investors have invested so much money in MFI, it is out of a desire to better the lives of those living in an economy that offers little opportunity. Although the poor tend to be the most trustworthy recipients of loans, investing in an MFI is of such little financial interest for a single individual that such investments, for the most part, (Compartamos being an exception) must come from good intentions. Yet simply because not all MFI are lucrative profit seeking banks, and because westerners usually care to help those they lend money to, does not mean that microfinance works.

Let us study the case of a small village in a developing country in which a Microfinance Institution has just been created. This MFI would determine which of the villagers are 'worthy' of a loan, and would supply these with money to create or expand their own businesses. There will inevitably be a rise in competing businesses; a newly funded entrepreneur will decide to open a bakery, even though the village already has one. With his/her funds, this entrepreneur will now make enough bread to satisfy the village's demand, and the first baker will go out of business. As simplistic as this example may seem, it perfectly illustrates the notion that, in a market economy, there is a loser for every winner.

How can this model ensure social justice? It hardly seems fair that one man should lose everything in order for another man to make a profit that suits his desire. One can only be puzzled that after all the progress mankind has made toward social justice, the economic model that is quasi-unanimously accepted or promoted is one that runs by the rules of the survival of the fittest. And yet is there any other way? From the perspective of a culture that champions capitalism as the only viable model for a country to follow and as the only model that ensures that a success is 'fair' (only those who work hard earn hard, we are told), there seems to be none. In fact, in certain countries, capitalism seems to satisfy the culture

A major mistake can nonetheless be pointed out in the world's approach to bringing wealth to developing countries: it does not take into consideration the innumerable differences of the cultures and people that make up each country. Granted, it has tried to 'tailor' microfinance to suit a country's identity. For example, microfinance in Bangladesh targets agriculture, because of the densely populated rural areas, whereas in Western Africa, where villages are miles apart, it targets urban entrepreneurship. Yet this approach remains misguided. In theory, this approach has taken into consideration the characteristics of a country and adapted itself to them. In fact, however, by changing the approaches of microfinance, it has only 'tailored' capitalism, a model the West has been trying to export, to a country's profile rather than 'tailor' an economy to said country. Who is to say that capitalism must work everywhere? We must not alter the exterior of capitalism so as to try to make it fit somewhere it does not. Can we not accept that an economy other than a market one may work?

Esther Duflo, a French professor of development economics at M.I.T. and co-founder of J-PAL (Poverty Action Lab) at the university, has pioneered a new, and controversial, way of approaching poverty reduction. This highly scientific approach consists in "subject(ing) social policy ideas to randomized control trials, as one would use in testing a drug." By testing very large groups, Duflo aims to eliminate small details that false the experiments that are usually made non-scientific subjects. One such experiment aimed to determine whether selling mosquito nets at a very low price would be a more effective way of combating malaria than simply giving these out. The idea was that people were most likely to use something they've paid for. It consisted in randomly dividing the tested population into two large groups, one that paid and another that didn't. The trial was made in Kenya, and it was determined that handing out the nets for free in Kenya was a more effective way. Yet it may be that in another country selling the nets would be a better way of combating malaria, and only by conducting such trials can this be determined. Randomized trials seem to be the best way to tailor any approach, whether social, political or financial, to a certain country or population. They may even be the solution to the problem posed by development economics.