Microfinance and the Global Political Economy

Victoria Voelwoen Danaan
University of Salford, Manchester, United Kingdom

Abstract: *Microfinance has evolved as a financial and social innovation aimed at reducing global poverty through socio-economic empowerment of the poor. It has enjoyed a widespread patronage in the global economy in spite of the views held by its critics. Though many impact assessment studies have suggested that there are no convincing evidences to justify the massive interest andinvestments in microfinance, renownedinstitutions, politicians, philanthropist andgovernments have demonstrated commitment to advancing its cause. This paper examines how the global political economy has shaped the development of microfinance. Based on a descriptive analysis and review of related literature, its findings suggest that the major phases of transformation in microfinance have occurred in response to the interests of stakeholders in the global political economy.*

***Key Words and Concepts**: Microfinance, Financial, Development, Global Political Economy, Poverty*

I. Introduction

Microfinance has been variously defined or described as 'the offer of modest financial services to zero or low income clients'(Torre, 2006, p. 2), 'the provision of tiny loans to poor individuals who establish or expand a simple income-generating activity, thereby supposedly facilitating their escape from poverty'(Bateman, 2010, p. 1), 'a collection of banking practices built around providing small loans'(Armendariz & Morduch, 2005, p. 1), 'a powerful tool to fight poverty by helping poor people raise income, build assets and cushion themselves against external shocks" (Copestake, 2007, p. 1721). However it is coined, it has microcredit and provision of other financial servicessuch as savings mobilization and insurance at micro level as its key elements. Its aims include poverty alleviation, financial inclusion and socio-economic empowerment for the poor. Its services are provided by informal, semi-formal and formal institutions with varying degrees of regulation.

Proponents of microfinance describe it as the bedrock of economic empowerment and poverty alleviation which supports and sustains economic growth and development while citing the examples of many successful enterprises that had humble beginnings with small capital generated through one form of microfinance and then, with good vision and management, have grown to an appreciable level. It facilitates consumption smoothing by making it possible for the poor to borrow small amounts of money when they need it and repaying it when income is received thus compensating for the ups and downs of economic life (Bateman, 2010). It also has spill-over effects that improve the health, education and housing status of its beneficiaries leading to overcoming social problems in the society. It promotes gender empowerment through increased involvement of women in business sector activities (Hermes & Lensink, 2011). That is why international organizations like the European Union, United Nations and the World Bank have committed huge resources to microfinance programmes (Miled & Rejeb, 2015). Critics, on the other hand, believe it is largely incompatible with sustainable economic and social development on ideological grounds (Van Rooyen, Stewart, & De Wet, 2012). Their claims are further substantiated with examples of people and institutions with tales of negative experiences of microfinance. In spite of the differences in perspectives on microfinance, it has remained relevant subject in the global political economy. The aim of this paper is to explore how microfinance has evolved in response to the dynamics of the global political economy.

II. Microfinance and the Global Political Economy

Microfinance cannot be severed from global politics. Its development has been shaped by policies that emanate from the global scene.Fouillet, Hudon, Harriss-White, and Copestake (2013, p. S1) argue that 'understanding microfinance interventions at the local level requires the social and political analysis of global development architecture, while MF may also play a role in consolidating or cementing global political economy at its base'. Barry (2012) further demonstrates that all models of MFIs have unique features that shape political development through democratisation, social capital, and economic and political empowerment.Weber (2004, p. 356) aptly captures the essence of this paper in the following narrative;

> Microcredit approach to poverty reduction is strategically embedded in the global political economy. It has been appropriated primarily to facilitate the implementation of financial sector liberalization on a global scale. Additionally, the contexts in which these programmes are implemented also reflect the motive of achieving a form of social disciplining aimed at commanding compliance for neo-liberal restructuring more generally

The emergence of microfinance stemmed from the failure of governments through state-owned development banks and institutions to manage resources provided by international donors for development goals (Armendariz & Morduch, 2005). Narratives from various literature(e.g. Armendariz & Morduch, 2005; Bateman, 2010; Haldar & Stiglitz, 2016) indicate that microfinance was conceived as a direct intervention targeted at the poor themselves to evade government interference and inefficiency. It became a celebrated financial and social innovation for reducing poverty when its pioneer, Prof Muhammad Yunus was recognised globally for the successes attained in Bangladesh.The prominence of microfinanceis often associated with Grameen Bank which he established to offer financial services to the poorest of the poor who are often excluded by the commercial banks in Bangladesh. Yunusdrew inspiration from Akhter Hameed Khan who, in the 1950s, attempted a poverty alleviation initiative in East Pakistan (which later became Bangladesh) through micro credit. Khan's microcredit scheme was undermined by interferences of government officials and the elites who misappropriated the funds meant for the empowerment of poor members. Yunus targeted the poor directly by giving small low-interest loans from his personal resources to poor households to expand their businesses with the expectation that through the micro credit programme, the beneficiaries would be free from the trap of the money lenders, earn a little income for consumption and have little savings, thus overcoming poverty. Armendariz and Morduch (2005) recount that he was impressed that his little effort yielded income to the beneficiaries and enabled them repay their loans even without collateral, but sad that his resources could not sustain the flow of his vision. Yunus, therefore, approached and convinced the Central Bank of Bangladesh to support his initiative in empowering the poor through micro credit. Grameen bank was supported with funding by the International Fund for Agriculture and Development, Ford Foundation and the governments of Bangladesh, Sweden, Norway and the Netherlands. With the support he received, he extended the services from Jobra to Tangail in North Central Bangladesh andeventually attained a very wide spread and recorded many successes. This marked the beginning of reliance on subsidies in microfinance. Thereafter, other institutions followed the Grameen example in providing microcredit, micro-insurance and micro-savings to the poor. The Bangladesh Rural Advance Committee (BRAC) founded by Fazle Hassan Abed in 1972 and ASA founded by ShafiqualHaqueChoudry and others established in Indonesia, Malaysia, India and Bolivia were providing financial services targeted at poor people (Armendariz & Morduch, 2005; Bateman, 2010).

International donors and investors have committed huge resources to establish and support MFIs. While donors such as developed nations, bilateral agencies, multilateral organizations and foundations are largely driven by developmental goals, public and private investors bring in capital and expect profit on their investments. They fund financial service providers with a view to achieving both financial and development returns. The nature of their investments has direct bearing on the organizational structure, performance and survival of MFIs. However, recent developments indicate that many MFIs are unsure about their future funding(Chakravarty & Pylypiv, 2015). There are suggestions that microfinance has become politicized due to 'political scandals, mission drift and excessive commercialization' (Hossein, 2016, p. 1). The dependence of MFIs on external funding makes them vulnerable to shocks and also imposes risks on them. Their sustainability and outreach are dependent on the ever changing interests of actors in the global scene. Weber (2006, p. 37) established that the World Bank and IMF have piloted the 'global political restructuring' of microfinance over time. The support for microfinance in the global economy by these bodies is strong even though its efficacy in reducing global poverty has been a subject of debates among researchers. Some critics have argued that microfinance is not compatible with economic principles but one more aligned to a political agenda (Bateman, Maclean, & Galbraith, 2017).

The crises experienced in transiting from the 'poverty lending approach' to 'financial systems approach' were responses to shifts in focus or priority of the external funders occasioned by the reforms adopted in the implementation of the Washington Consensus (WC) of the late 1980s. The policy thrust of the consensus included: the deregulation of domestic markets, privatisation of public enterprises, liberalization of trade and financial flows. These were aimed at expanding investment opportunities in the emerging markets of poor developing countries, helping developing countries overcome their debt crises by creating the conditions for the build-up of capital and integrating them into the world economy(Khoudour-Castéras, 2010). The tide of these policies were too strong for the MFIs to retain their original focus and so, many of them, including Grameen Bank, had no option but to'bow to the inevitable and transform into a regular profit-driven financial institution(Bateman, 2010, p. 17).The resultant effect was high default rates and other adverse effects due to the high interest rates being charged by the MFIs in order to remain sustainable.Karaivanov (2018, p. 2509) however found that;

> Charging interest on funds provided by donors or investors to microfinance institutions (MFIs) can increase efficiency, the total number of loans and borrower welfare, compared to grant or concessionary funding. In a setting in which MFIs supply costly non-contractible effort, putting a price or raising the price of loanable funds strengthens the MFIs' incentives to put effort in credit administration or monitoring, to extend more loans, and/or reduce overhead costs.

The focus shifted again in the post-WC period from building commercialized financial institutions for the poor to a comprehensive financial sector development promoted by foreign donors and investors based on the adoption of a market development approach tagged 'making markets work for the poor'(M4P)(CGAP, 2014; Johnson, 2013). Following the neo-liberal phases of the WC and the post-WC, the global campaigns for access to finance as resulted in the 'marketization of development' with tremendous impact on the activities of MFIs(Carroll, 2015). This manifests in the intensive drive to enhance;

> competitive social relations and the internment of nation states into the global economy via modalities such as financial intermediary support, the relentless promotion of public-private partnerships, the extension of conditional lending and equity, and the benchmarking of countries in their realising of an enabling environment for capital accumulation(Carroll, 2015, p. 140)

The World Bank's promotion of financial intermediaries (MFIs and other banks) through its private sector arm - International Finance Corporation (IFC) indicates that there a global interest geared towards establishing and enthroning capitalist social relations in the underdeveloped world.Jiansheng and Yanan (2017) found that the focus of MFIs has shifted from poverty alleviation to seeking of institutional benefits based on the acceptance of technology. One key strategy for achieving this, is the promotion of Information and Communication Technology (ICT) to provide digital payment systems that would facilitate the flow of capital to poor countries for development. This has led to the increasing use of digital channels such as mobile phones, Automated Teller Machines (ATMs) and Points of Sale (POS) terminals to provide services to the unbanked. The use of ICT has enhanced the provision of banking services while reducing the operational costs of banks (e.g., buildings, manpower, security etc.) and cost of travelling to access services for users(Singh & Padhi, 2015). The adoption of ICT by MFIs is valuable for enhancing their operational efficiency, managing risk and expanding outreach. Thus, many MFIs are embracing it in order to remain viable in a more competitive environment(Kauffman & Riggins, 2012).Mia and Ramage (2015) suggest that the adoption of ICT by MFIs can lead to decrease in the interest rates they charge clients and help them upscale their operations. It is fast becoming an effective instrument for financial inclusion globally as CGAP reported that'in Bangladesh more than 1 in 5 people were using mobile financial services at the end of 2013, and in Kenya, 12.2 million or two thirds of all adults use the mobile phone-based money transfer and payment service M-Pesa' In its drive to strengthen jobs and value creation, CGAP has launched initiatives such as the Digital Finance Plus - aimed at providing critical services and utilities to communities using digital channels; Digital Finance Frontiers - aimed at enhancing better services through creation of consumer database, and the Inclusive Payment Ecosystems aimed at strengthening regulation and consumer protection digitally. ICT and data analytics are being employed by micro financial service providers to track consumer's the change in demand and enhance the delivery of more efficient products and services(Parikh & Singh, 2018).

While these are worthwhile initiatives for advancing development and poverty reduction, there are challenges obstructing the attainment of financial inclusion through the adoption of ICT especially to low-income households. These include poor rural mobile network connectivity, low rate of mobile literacy, lack of access to facilities such as the internet, smart phones and failure of providers to design products that suit the needs of the poor(CGAP; Kauffman & Riggins, 2012). Other limitations are low level of awareness, low income and unemployment(Ammar & Ahmed, 2016).

The survival of MFIs in recent times has also been threatened with the changing pattern of funding from poverty and development goals to security concerns following the threats of terrorism. McConnon (2014, p. 138) observes that;

> rather than a renewed poverty focus, a clear shift of development spending to meet 'war on terrorism' demands can be seen in the status of Iraq, Afghanistan and Pakistan as DFID's top recipients, whereas prior to 2001, they were not in the top 20 recipients".

This trend suggest that policies are changing because these countries and other developing countries pose serious security threats to the developed world. Therefore, investments are being channelled to them to strengthen the free market ideology and democracy. In their cross-border funder survey of 2014, CGAP, in collaboration with Microfinance Information eXchange (MIX), reports that funding for financial inclusion remained unchanged for years 2013 and 2014 at $31 Billion, and the weaker Euro(significant investment comes from the euro-zone) even caused a slight decrease in dollar value. It also reported an increasing interest in funding to the Middle East and North Africa to further confirm the shift in focus(Soursourian & Dashi, 2015). If the trend continues, there would be serious implications for development of the sector.

The politics of religion is also a factor shaping modern microfinance. In order to enhance the socio-economic inclusion of low income people whose faith and beliefs are hindrances to their financial inclusion, there is a growing interest in Islamic microfinance which offers alternatives to western financial services.Bourhime and Tkiouat (2018) establish that this interest has been stimulated by the global financial crisis which rocked many renowned conventional financial institutions. Grounded in the design of Shariah Law-compliant financial products and services, Islamic microfinance is mainly characterized by disbursement of interest-free credit. Several lending models are being developed, and sources and uses of funds are dictated by the principles of Islam (Tamanni & Liu, 2017).Mohammed, Abdur Raqeeb, and Waheed (2018) reveal that 'Islamic finance is a modern concept emerging at global level. Growing with an annual growth rate of 15-20 percent the Islamic finance industry is holding total assets, value estimated to be more than USD 1.6 trillion'.Adewale and Haron (2017) argue that Islamic social finance platforms especially Islamic microfinance contribute significantly in the financial inclusion of Muslim populations who have been excluded from modern banking.

The effect of global politics on the microfinance sector is also glaring when analysing the bilateral relations between countries. Garmaise and Natividad (2013) reveal that political proximity and affinity between the host country of the MFI and the country of its lenders influence the volume of capital flow and other incentives like reduced interest rates. Specifically, they identified similarity of voting patterns at UN General Assembly as a key factor that facilitates the provision of low-priced credit from foreign investors. These expositions show the effects of global politics on the performance of MFIs as a result of their dependence on foreign donors and investors, and have serious implications for their sustainability.

III. Conclusion

This paper has discussed the influence of the global political economy on the development of microfinance. Its findings indicate that the major advances in microfinance –reliance on subsidies, commercialization and liberalization, ICT and digitalization, changing pattern of funding (with new interests in the Middle East and North Africa), Islamic Microfinance and international relations are driven by the interests of powerful stakeholders in global political economy. This foreshadows the factors that would underpin the future development of the sector and point to the opportunities that would enhance the sustainability and outreach of MFIs globally.

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