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Microfinance North and South: Contrasting current debates

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Abstract

This paper sets out to examine the apparent consensus around microfinance as a tool to address poverty and social exclusion in North and South. The current emphasis on scale and sustainability in Southern microfinance practice fits the 'counter revolution' in development thought but contrasts with the origins of community banking in the North. The roots of the latter lie in a critique of mainstream economic and financial systems and seeks to re-invent them in ways that bring social, economic and environmental costs and benefits into focus. The role of microfinance in building sustainable livelihoods, both economic and social, is then examined. Finally, it is suggested that, as with any intervention, microfinance has no inherent capability to address gender inequities but must be deliberately made to do so.

An area of current and growing interest is the recognition that poverty is not an exclusively southern phenomenon and that debates about social exclusion in the North and poverty in the South may have much to learn from each other. Late 20th century economic and social processes appear to be producing a "South in the North" at the same time as rapid development in some contexts is resulting in the emergence of a "North in the South". The exploration into the similarities and differences is still at an early stage and there is a growing agenda of inquiry into the comparisons, convergence and connections which these parallel debates and processes offer (O'Brien, Wilkes, de Haan and Maxwell,1997).

One area in which parallels are already being drawn is in the arena of microfinance practice. The recent Micro Credit Summit held in Washington in February 1997 brought together practitioners from both North and South in the fields of microfinance and microenterprise development. This umbrella produced an apparent consensus on the applicability of microfinance and microenterprise to address issues of poverty in both North and South which embraced a massive scope of organisations and approaches. It is the purpose of this paper to delve more deeply into this seeming consensus and explore how far this convergence actually goes.

The paper starts by considering the origins of the currently dominant axes of microfinance debates in both the North and South. It proceeds to an examination of the emphasis each approach puts on, first, local economic development and, second, the role of social capital and cohesion. Gender aspects of microfinance are then reviewed before concluding.

1. Contrasting origins

The view that there is a capital constraint to growth at either the national or household level has been one of the cornerstones of post-war development strategies. The response was to make available cheap loans, whether at the macro level through the mechanism of multi-lateral and bi-lateral donors to national governments, or at the micro level through development finance institutions and related government programmes to households. The current emphasis on microfinance and particularly micro-credit is thus an old debate with a new gloss. What is different in the latest chapter of this story is the idea that lending capital to poor people to alleviate household level capital constraints can be done in ways which ensure the sustainability of the institution delivering the service.

Previous experience with credit had generally been poor: repayment rates were low, interest rates were subsidised, the cost of running the schemes was high because relatively small volumes of credit were delivered direct to individuals with high supervision costs and high rates of default. Over the last 10-15 years a number of initiatives across the world have evolved technologies for lending to poor people which have overcome some of these failings. For example, the finding that small but regular repayment of loan instalments fitted better the ability of poor people to manage this credit than demands for the return of principle and interest as a lump sum. A range of innovations in access methods, screening of borrowers and incentives to repay have helped to raise repayment rates and present poor people as credit-worthy borrowers. Furthermore, poor people have been willing and able to pay market interest rates for these loans. The reputation of the Grameen Bank in these developments is widespread, but experience is more varied and includes, among others, the oft quoted experiences of institutions such as BRI in Indonesia, BancoSol in Bolivia and K-REP in Kenya.

The implications of this shift in the 'technology' of delivering credit to poor people go further. The evidence that repayment rates are high, means that the scheme itself starts to offer the prospect of becoming financially viable. This leads to a desire for scale in the operations of the scheme in order to reduce unit costs sufficiently to bring them into line with interest income. This potential for both scale or 'outreach' to large numbers of borrowers and for 'institutional viability' are at the heart of 'New World' thinking (Otero and Rhyne, 1994).

This emphasis on scale and sustainability are evidenced in the materials of key players in the field such as USAID, the World Bank, the multi-donor Consultative Group to Assist the Poorest (CGAP) and NGOs such as ACCION. At the same time the twin concerns of outreach and sustainability found their way into the Declaration of the Micro Credit Summit held in Washington in February, 1997 as dominant themes (RESULTS, 1997). This is not to say that all microfinance practitioners in the south agree with the orientation of this approach and that it goes unchallenged. Indeed, many practitioners founded their initiatives on a critique of mainstream thinking. But the dominance of this approach is now evident from the fact that practitioners tend to have to justify to donors their deviation from it rather than compliance with it.

Debates over scale and institutional viability are ongoing. Moreover, only a very few microfinance institutions born of NGOs have yet achieved institutional and financial viability (Christen, Rhyne and Vogel, 1994). The benefits of building financial institutions which can support their users for the long term are undeniable. However, the circumstances and potential for achieving this across a range of socio-economic, socio-cultural, agro-ecological and physical contexts are much less clear since these differences significantly affect the costs of both 'social' and financial intermediation (Bennet, Goldberg and Hunte, 1996; Webster and Fidler, 1995).

The emphasis on scaling up has caused concern because some organisations obtain their strength from their relatively small scale and believe that their ability to address poverty will be compromised by scaling up, as this often leads to a reduction in the related support and services which poor people require. A further concern is the potential trade-off between poverty focus and sustainability as institutions find it easier and more profitable to work with those who can manage larger loans and may therefore 'graduate' away from their original membership bases. Alternatively, if well managed, there is the potential for organisations to cross-subsidise services to poorer users with the profits on services to better off users. Indeed the potential trade-offs between impact and sustainability are increasingly being discussed in the literature (Hulme and Mosley, 1996; Johnson and Rogaly, 1997; Mayoux and Johnson, 1997).

The emphasis of 'New World' thinking on scale and sustainability fits the 'counter revolution' in development thought (Toye, 1993) in which the functions of the state are rolled back and the market is rolled in to make efficient allocation decisions, in a number of ways. First, the emphasis on the financial sustainability of the institutions fits with the logic of the market taking over and the desire for subsidies to be removed. Second, the channels of delivery are privatised through the use of NGOs and similar agencies usually outside the direct ambit of the state. Third, the provision of credit with the expectation of poverty alleviation relies on the idea that poor people are the "budding micro-entrepreneurs" (Rogaly, 1996) of neo-liberal theory, whom a loan will launch into productive economic enterprise and a virtuous cycle of income generation, investment and further growth will result. Such expectations run counter to an understanding of poverty which deals with interlocking dimensions of powerlessness and the societal and political, as well as economic, constraints that poor people face.

To conclude, there is little within this approach to microfinance in the South which questions mainstream economic thought about poverty, development and the role of markets. This picture seems to contrast significantly with the mainstream of debate around community banking in the North.

The term community banking is used here to cover a range of models : commercial development banks; community development credit unions; community development loan funds; micro loan funds and community exchange systems (Mayo 1996). Developments in the north, and in the UK in particular, appear to be rooted around two main concerns. First, (and similar to the South) the practical failure of the mainstream formal banking sector to serve the needs of low income groups. This failure arises from the need for this sector to increasingly respond to deregulation, new technology and the globalisation of international capital markets (Mayo 1996) and has resulted in the closure of bank branches (1,000 in the 4 years to 1993 in the UK) and low consumer confidence (Mayo 1993). The term 'financial exclusion' describes the process by which many lose access to the basic mechanisms through which they can manage their money (Kaur, Lagnayah and Mayo, no date). While the allegation that banks employ the practice of 'red-lining' (a consistent policy of closing banks in deprived areas) has not been substantiated in the UK, Kaur et al argue that the effect of such closures is the same since "bank branch closure is fastest in more deprived wards (in London), exacerbating existing inequities in terms of access to financial services".

This practical concern about financial exclusion appears to mirror the inability of formal banking systems in the South to meet the needs of poor people but its origins are rather different. This failure in the North is born of the excesses of market forces rather than their under-development. New technology has led to the ability of financial service providers to segment their markets precisely and effectively in the context of rampant competition, so forcing them to ensure that returns in any market segment are being maximised and cross-subsidy between different parts of the business is being kept to a minimum. Ironically, the problem has come full circle. While the problem of financial market fragmentation due to imperfect information and high transactions costs exists in the south, the volume of information and low transaction costs in the north are propelling markets to new levels of segmentation.

The ideological and theoretical origins of the community banking movement in the North are located within a strand of 'green' and 'new' economics which sees conventional monetary and banking systems as compounding the excesses of consumption and accumulation. The way in which economic and financial markets are developing are seen as "out of control" (Douthwaite, 1996) and revolving around "money fetishism" (Daly, 1992). These processes are critiqued as taking inadequate account of the environmental and social costs they impose, and the search is underway to re-conceptualise wealth in ways that value people and the environment, and to build alternative economic systems which can put a different value framework into practice.

There appears then to be a fundamental difference between the underlying origins of approaches to microfinance in North and South. The increasingly dominant paradigm in Southern microfinance is one in which scale and sustainability are the watch words and which is convergent with mainstream economic thinking to develop markets and remove subsidies. By contrast the community banking debate in the UK is located within a critique of mainstream economic and financial systems and seeks to re-invent them in ways that bring into focus social, economic and environmental costs and benefits.

Having identified these ideological and historical differences, the next two sections draw contrasts between the economic and social functions of financial systems in North and South.

2. The role of financial systems in building sustainable local economies

The northern community banking debate exists within a wider debate about community economic development and is concerned with the role of financial intermediation in developing and maintaining the health of local economies. This concern recognises that money has a local multiplier effect and that the more it circulates locally before exiting, the more it will create jobs and wealth within the area. This leads to an emphasis on self reliance and an aversion to money flowing out of areas. Douthwaite illustrates the point by the way in which banks literally truck money out of communities in the US. Another illustration would be, the South Wales miners whose past savings in the form of pension contributions invested through conventional financial systems might be currently enabling investment and employment for people in other parts of the UK or the world, while they themselves languish with few employment opportunities. Investment to provide new employment in South Wales has tended to come from external sources in the form of transnational corporations taking advantage of incentives (ie subsidies) to establish plants in the area rather than local savings being used for investment purposes. In this context, 'new' and 'green' economics demand a different relationship between social and financial priorities.

While the lack of a banking facility can "pull the plug on the local economy for an entire community by closing down inner city branches" (Big Issue quoted in Kaur et al, op cit) because it makes banking more difficult for local businesses and the local community, it is clearly the nature of the banking facility that is the issue at stake. Douthwaite highlights the need for *locally owned and controlled* banking facilities as "investor's interests are rarely compatible with those of a community" (1996, p58). However, local ownership and control are only possible if resources are locally generated. That is, the system must be able to mobilise sufficient savings and local equity rather than external capital in order for local control to be retained. Indeed, this perspective also tends to suggest an aversion to scale in financial intermediator systems which would tend to move (apparent?) surpluses of investible funds to areas of deficit to equalise rates of financial return across space.

Credit has dominated the Southern microfinance debate, it is only recently that savings have come to the fore of the international discourse and been recognised as a service to which poor people need access (Robinson, 1995; Rutherford, 1995). This is part of a wider appreciation of the needs of poor people for a range of financial services extending from savings, insurance and money transmission to products which will enable them to deal with medical emergencies or build a house. Despite the emergence of this broader view of the financial service needs of poor people, the identity of the microfinance literature with that of microenterprise development is still overarching.

At the macro level also there is renewed discussion of how to increase aggregate savings rates and reduce the investment-savings gap in order to fuel investment for growth (World Bank, 1995). However, while development agencies highlight the importance of sustainable livelihoods at the micro level, the role of microfinance systems in mobilising local savings for local re-investment has not in general been emphasised at the meso level.

This point can be further illustrated by the recently held Micro Credit Summit. This initiative seeks to raise $21.6bn in order to provide 100m poor people with credit by the year 2005. The potential sources of these funds are viewed by the organisers as many, including international commercial capital markets. Indeed the case of BancoSol floating Certificates of Deposit on Wall Street is now much quoted and looked to as an example of how to bring in "premier financial institutions on a strictly commercial basis" (RESULTS, 1997).

The question posed here is whether all capital is 'good' capital or whether there are critical considerations to be made about the sources of funds and the quality of the relationships they involve. Critically, to whom and how it is accountable. Northern debates have emphasised concerns about the sources of capital and the nature of the financial systems which move capital around. They tend to emphasise the need for such capital to be 'rooted' in space within an alternative value framework in order for local financial institutions to promote local economic health and wealth. By contrast, advocates of the 'New World' in the South, currently ask few questions about the sources of capital, nor of the qualitative nature of the financial institutions being built.

3. Social capital

An apparent similarity between debates in North and South is in their attention to social capital defined by Putnam as the "networks, norms and trust that facilitate co-ordination and co-operation for mutual benefit" (Putnam, 1993). Northern debates in searching for alternative models of economy and society see systems of financial intermediation as a key feature not simply of ensuring local economic wealth but also of local social health. Social relationships can be built as well as destroyed by systems of economic interaction. In the North, old style so-called 'relationship banking' has given way to the technology of cash machines and credit ratings agencies in which people become a balance sheets of assets, liabilities and income rather than individuals with talents, creativity and a contribution to make to society as a whole. Indeed the situation in which a local bank manager would know his (sic) customers would also be likely to lead to an assessment of risks and returns which would take into account wider considerations than simply financial returns. Such systems emphasise face to face interaction and transaction. The search for alternatives in the North has led to an emphasis on credit unions built around the common bond of a local community and Local Exchange Trading Systems (LETS) schemes, one of the benefits of which can be the social interaction that trading brings about (Lang, 1994).

However, the concept of social capital as a "missing link" in development (Harriss and De Renzio, 1997, p929) to explain how actors organise themselves has recently become something of a catch all. Discussion has tended to ignore power relations and the exclusion which results from being outside of these networks - what Putzel (1997) calls the "dark side" of social capital. Harriss and De Renzio therefore define "social networks and associational life" more specifically as " groups and organisations that link individuals belonging to different families or kinship groups in common activities for different purposes" (p932). Such relationships are a strong feature of many indigenous financial systems in the south. The diversity and ubiquity of these informal systems is the subject of a wide literature. These arrangements can be categorised as those "for profit" and those which are "user owned" (Rutherford, 1996). While it is clearly the case that some local financial arrangements are exploitative rather than enabling for poor people, user owned systems are likely to be more enabling and supportive because the profits are pooled and shared or fed back into the system, and ownership and control of the funds are in the hands of the users (Johnson and Rogaly, 1997).

In the north, these types of informal systems tend to operate more within immigrant communities in the UK and US, such as Jamaican 'partner' arrangements in the UK and 'hui' among Vietnamese immigrants to the US. However, the original format for the 'terminating' building society in the UK was based on similar principles to the basic ROSCA and dates back to the

18th century.

Community banking advocates stress that local financial systems can aid the regeneration of poor communities in the North. In the South, many NGO schemes are based on groups and some build from existing indigenous systems. However, a danger of the dominant paradigm's pressure for scale and sustainability is that schemes may lose their social orientation.

The following diagram seeks to illustrate these dynamics:

The emphasis of community banking and related northern initiatives is clearly to find ways of building social capital into financial systems. This seems to be happening in two ways. First, formal banks such as the Cooperative Bank in the UK are taking a stakeholder view of their operations and attempting to build in the interests of customers, staff and the wider community rather than only their shareholders (Cooperative Bank, 1997) . Also in the formal sector, Triodos Bank is an example of an institution finding ways within conventional banking instruments, such as deposit accounts to introduce ethical and social concerns by enabling the investor to determine which sectors she wants her savings to be invested in. On the other hand, credit unions, LETS schemes and micro-loan funds are being seeded to expand the options in the high social capital but low financial capital quadrant.

In the South, there are many systems which can intermediate small volumes of capital both with low social capital and 'for profit' (eg money lenders) and with high social capital ('user owned' informal systems). NGO microfinance interventions initially and on the whole might fit the high social capital and low volume of financial intermediation quadrant. However the dynamics of microfinance in the south seem to be towards scaling up the volumes of financial intermediation undertaken. What is not yet clear is to what extent and how the social relationships involved are to be maintained and developed, or whether NGOs in converting themselves into registered and regulated financial institutions might begin to enter the 1st quadrant and simply become part of the mainstream financial sector which is motivated by profit rather than people. The bias of the dominant 'New World' approach does not clearly put any emphasis on the quality and nature of the social relationships involved in scaling up and whether and how they are likely to change with an emphasis on sustainability.

4. **Engendering microfinance north and south**

The success of some of the most well known Bangladeshi microfinance institutions in enlisting large numbers of women amongst their members has led to the growing belief that microfinance is an intervention uniquely beneficial to women. While addressing a mainstream development intervention towards women is a welcome corrective to previous neglect, the assumption that receiving credit is necessarily empowering for them requires further examination.

A growing literature is examining the impact of microfinance, in particular, credit on gender relations. Goetz and Sen Gupta (1995) writing on Bangladesh demonstrate that the fact that women belong to the schemes and have access to loans does not mean that they retain control once the funds are inside the household. Mayoux (1997) drawing together a range of evidence from South Asia and Africa demonstrates the variety of effects - both positive and negative, on women, intra-household gender relations and women's relations to the wider community and society that are evidenced in practice. This leads to the, perhaps unsurprising, conclusion that transactions around microfinance are located within existing sets of gender relations both within the household and within the wider society. Like most interventions it is necessary to specifically orient microfinance interventions towards addressing aspects of these relations in order to have systematically positive impacts on gender relations for most women, most of the time. Yet again this means that it is the way in which an intervention is implemented that matters.

Northern debates around Community Banking have not been notable for their discussion of women or gender. Green and 'new' economics have made steps towards addressing aspects of ways in which gender relations affect the economy and society. The area in which this has mostly been developed is in valuing domestic work (Ekins and Max Neef, 1992) and initiatives such as the Index of Sustainable Economic Welfare (NEF, no date) have valued the services of domestic labour.

As with any initiative, microfinance interventions in both North and South will only address gender inequalities if they are made to do so. In practical terms this requires gender policies on the part of the implementing agency; complimentary services which address gender differences; conditions of microfinance service delivery which are flexible enough to meet women's needs and the means through which women can participate in decision making and strategy of the intervention (Mayoux, 1997). At the same time there is still further thinking and experimentation to be done about the ways in which alternative economic and financial systems can address in-built gender biases if community banking initiatives are to help to deliver a truly alternative system of gender relations in the economic sphere.

Conclusion

This exploration of microfinance debates North and South has drawn out some key points of contrast and similarity. It has highlighted important underlying differences between the currently dominant 'New World' approach in the South and the community banking approach in the North. Northern initiatives are located in a critique of the way conventional financial and economic systems have segmented markets in their drive to retain profitability in an increasingly competitive environment, and in a search for alternative models of financial intermediation which bring social relationships and the health of local economies back into view. By contrast, the paradigm which has been described here as now driving southern microfinance programmes appears to be rooted in a conventional view of financial intermediation including a focus on profitably in order to achieve long term sustainability.

While both sets of initiatives see reducing poverty and social exclusion as priorities, the means through which they seek to achieve these goals have some important differences. The 'New World' in southern microfinance seeks to develop financial markets in ways that do not fundamentally challenge the logic of those markets. The nature of financial services envisaged by northern community banking is fundamentally a critique of the neo-liberal economic paradigm and is seeking to build a "social oriented banking system" within an entirely different value framework. Does the 'New World' in southern microfinance offer us anything really 'new' or just another dose of the old economic formula?

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