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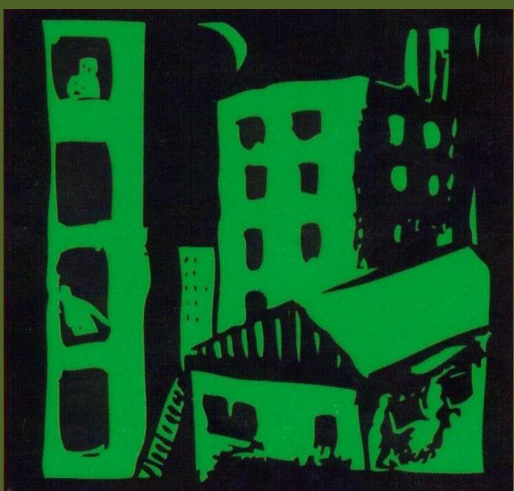

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South Africa's post-apartheid microcredit-driven calamity

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1 INTRODUCTION

Thirty years ago, the international development community was abuzz with excitement. The reason was that the almost perfect solution to poverty, unemployment, inequality and low growth in developing countries appeared to have been finally located. This solution was *microcredit*. As originally conceived, microcredit is the provision of tiny micro-loans to the poor to allow them to establish a range of

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income generating activities, thereby supposedly facilitating an escape from poverty.[1] A widespread assumption quickly emerged suggesting that the microcredit model would, among other things, generate significant local employment opportunities, raise average incomes, empower women, reduce inequality, and so, overall, create the basic foundation for sustainable "bottom-up" local economic and social development. Not surprisingly, given such assumed benefits, microcredit was quickly and very centrally incorporated into the international development community's array of local development policies and programs, ultimately becoming the most important international development policy of all.

South Africa is one of the many developing countries that opted to deploy the microcredit model as a poverty reduction and local development initiative. Even before the end of the apartheid system the international donor community had arrived in South Africa to help set up new microcredit institutions (MCIs). The end of apartheid then saw this effort stepped up considerably. Much more importantly, changes to South Africa's financial system encouraged South Africa's traditionally strong private commercial banks to begin to "downscale" into microcredit operations. The very high profits subsequently realised by a number of these banks then encouraged a whole new raft of profit-driven banks and MCIs to get into the business of microcredit. The supply of microcredit began to increase even faster than before. Many well-placed microfinance advocates began to argue, and still do,[2] that South Africa's poor black majority would soon be enjoying an historically unprecedented "bottom-up" self-help led positive transformation in their lives and communities. And even though in the years after the end of apartheid researchers could find no solid evidence to show that anything remotely like this uplifting scenario was actually taking place,[3] this did not appear to matter. Now shifting the argument in favour of microcredit onto other grounds, notably the idea of "financial inclusion", it was possible to maintain that microcredit had been an important positive factor merely because of the fact that it had been made widely *available* to the poor. South Africa's microcredit industry, as well as the international development community, business elites and politicians, thus continued to celebrate the microcredit model as one of the most successful of the many post-apartheid policy initiatives.

This article takes a completely different approach. I centrally argue here that the evidence in South Africa actually shows the microcredit model to have been one of the most calamitous policy and program interventions in the post-apartheid era. Today, as in many other developing countries, the sheer precariousness of the microcredit model

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[1] "Microcredit" is the original name for the innovation discussed here, but in the early 1990s the wider concept of "microfinance" was coined as an umbrella term to cover microcredit, micro-savings, micro-insurance, etc. Here I will use the technically correct term microcredit, but, unless otherwise stated, the terms are essentially interchangeable.

[2] For example, high-profile Zambian economist Dambisa Moyo – see Moyo D *Dead aid: Why aid is not working and how there is a better way for Africa*. (New York: Farrar, Straus and Giroux 2009) at 126-141.

[3] Stewart R, Van Rooyen C, Dickson K, Majoro M & De Wet T, *What is the evidence of the impact of microfinance on the well-being of poor people? A systematic review of evidence from Sub-Saharan Africa. Technical report.* (London: EPPI-Centre, Social Science Research Unit, University of London 2011).

is even beginning to threaten the very foundations of South Africa's financial system. My specific arguments will particularly emphasise, first, the additional important impetus provided by the microcredit model to the ongoing deterioration of South Africa's already weak economic structure. Rather than microcredit having produced large numbers of flourishing growth oriented enterprises, and so also flourishing and growth-oriented local economic spaces, we have seen instead what amounts to the programmed de-industrialisation, informalisation, disconnectedness, and primitivisation of the local economy. That is, those local economies most exposed to microcredit have effectively been helped to "dumb down" not "scale up", and so increasingly find themselves caught in a poverty trap of their own making. I also go on to note that the long-term impact of the microcredit model on social institutions and individuals is equally negative, further destroying post-apartheid South Africa's already thin reserves of intra- and inter-ethnic community trust, mutuality, reciprocity and solidarity. In the very worst case scenario, the market-driven microcredit model has directly, and knowingly, helped to create the conditions that eventually precipitated physical violence.

The article begins by providing some necessary background to the global rise and recent fall of microcredit. I start by outlining the microcredit model's origins and initial supposed successes, before I then briefly document the key evidence showing that the microcredit model has not just failed on its own terms – poverty reduction and sustainable "bottom-up" development - but has actually been *destroying* the chances of achieving these important goals in developing countries. To aid the analysis, section three then briefly outlines what I call a "developmental" local financial model, one that is built upon the key insights and experiences arising in a variety of countries and regions that, not unlike in the case of South Africa, have undergone a major transition from one economic and/or political system to another. I present this simple model as the obvious counterpart to the "anti-developmental" microcredit model discussed in section two, and which has taken root in South Africa since 1994. This detail is provided not just to illuminate and expand the discussion of local finance, but to forestall a possible charge that the argument presented here is incomplete if I do not adumbrate any of the alternative local financial models to microcredit, which might conceivably be even worse than microcredit. In section four, I turn to the experience of South Africa itself. I briefly point out that the early experience of the microcredit model was less than encouraging, if not an outright disaster, but that the microcredit model was persisted with nevertheless, among other things because a narrow stratum of South African society – *the institutional suppliers of microcredit* – found that they could derive enormous financial benefit for themselves. Section five then goes on to summarise the key areas where the microcredit model has served to undermine and destroy local economic and social development progress in the post-apartheid era. Finally, in section six I briefly recount one of the most disturbing recent developments in South Africa and how it links the microcredit model to extreme exploitation, over-indebtedness and desperation, conditions that then, arguably, gave rise to the outbreak of the most violent episode since the post-apartheid era began – the "Marikana Massacre" that took place on 16 August 2012, claiming the lives of 34 demonstrating miners.

2 BACKGROUND TO THE MICROCREDIT MODEL

2.1 The beginnings

As is well known, the microcredit model is most closely associated with the US educated Bangladeshi economist and 2006 Nobel Peace Prize winner, Dr Muhammad Yunus, and his work in the village of Jobra in Bangladesh in the 1970s. Famously lending USD 27 out of his own pocket to 42 women in Jobra, with the money being promptly returned in full, Yunus conceived of a new way for the poor to escape their poverty en masse: by encouraging every last one of them to access a micro-loan and get involved in simple informal income generating activities, such as, petty retail trade, basket-making, home production of simple items, rickshaw driving, and so on. Although initially met with scepticism from his peers in Bangladesh,[4] who pointed out that most of Bangladesh's poor communities, including Jobra itself, were *already* pretty much adequately supplied with the sort of very simple products and services that Yunus's informal entrepreneurs were hoping to sell,[5] Yunus's uplifting message did not fall on deaf ears. On the contrary, many were listening very intently. Not least because he took to grandiosely claiming that microcredit would "eradicate poverty in a generation" and that children would have to go a "poverty museum" to see what all the fuss was about, Yunus was soon being viewed within Bangladesh as a major authority on poverty reduction. In 1983 Yunus was able to tap into international funding in order to establish his own "Bank for the Poor", called the Grameen Bank ("Rural Bank" in the local language). Thereafter for more than 30 years Yunus was able to run the Grameen Bank as his personal fiefdom, before being ousted by the Bangladesh government in the light of numerous charges of developmental inefficiency, mismanagement and unethical behaviour.[6]

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[4] For example, Ahmad QK & Hossain M, *An evaluation of selected policies and programmes for alleviation of rural poverty in Bangladesh* (Dhaka: Bangladesh Institute of Development Studies 1984); Osmani SR "Limits to the alleviation of poverty through non-farm credit" (1989) 17(4) *Bangladesh Development Studies* 1.

[5] The sceptics were more or less proved right many years later, however. Except for a few bright spots of wealth that can almost all be traced back to an individual having secured a period of formal employment abroad, especially in the Gulf States, Jobra is today just as poor and underdeveloped as it was in the 1970s in spite of it receiving more microcredit per capita than probably any single location on the planet. The only visible change that is undoubtedly attributable to the arrival of the microcredit model in the early 1980s, moreover, is a negative one: *rising individual over-indebtedness*. See Kaisar O & Bhattacharya S "The Jobra of Yunus: poverty there has not found itself in an archive (museum)" *Bhorer Kagaj* (Dhaka), 10 March 2007 (the partial English translation of this newspaper report can be found at Chowdhury F "Debt death desertion" in Chowdhury F (ed) *Microcredit: Myth manufactured* (Dhaka: Shrabon Prokashani 2007) at 202-204.

[6] In the light of a number of claims of Yunus's mismanagement of the Grameen Bank, the Bangladesh government commissioned a report from a panel of eminent and independent persons that would look at how the Grameen Bank had been run by Yunus down the years and, in particular, what its relationship was to the more than 40 affiliates (including for-profit entities) it had set up. The Report when it appeared in 2013 was explosive, containing carefully detailed and corroborated instances of mismanagement, governance inefficiency, serious ethical lapses, and claims of obvious civil, if not criminal, liability on the part of Yunus himself. See "*Interim Report of the Grameen Bank Commission*" (9 February 2013). Available at http://www.mof.gov.bd/en/budget/gb/Grameen_Bank_Interim_Report.pdf (accessed 24 April 2014).

Almost right from its establishment Yunus began to claim that the Grameen Bank was making a massive contribution to poverty reduction in Bangladesh. However, Yunus had no empirical support whatsoever to back up his important claims,[7] a fact that upset a number of internationally well-known development economists at the time.[8] Nonetheless, in due course Yunus began to receive invitations from the international development community to help promote microcredit around the developing world. Many developing countries were soon responding to Yunus's invocations by establishing rafts of their own MCIs along Grameen Bank lines. Under the driving force of United States Agency for International Development (USAID) and the World Bank, joined by the Inter-American Development Bank (IDB), the African Development Bank (AfDB), and the Asian Development Bank (ADB), financial, technical and political support for the microcredit model was massively stepped up right around the world.

Importantly, and once again led by USAID and the World Bank, steps were taken in the late 1980s to fully commercialise (one might also say "neo-liberalise") the microcredit model. This new direction was taken in order to ensure that microcredit would conform to the standard neo-liberal imperative of "full cost recovery", a concept that dogmatically specifies that no organisation should function in a market economy as anything other than a financially self-sustaining one. Continued reliance upon international donor and government subsidies was simply out of the question. In future, as the most impassioned commercialisation advocates argued,[9] "healthy" MCIs should be expected to operate like any other for-profit organisation and "earn their keep on the market".

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[7] Later on, however, Yunus took to using the results of a major World Bank study on microcredit in Bangladesh to make the important claim that "5% of Grameen borrowers escape poverty every year". The 5 per cent figure is given in Khandker S *Fighting poverty with microcredit: Experience in Bangladesh* (New York: Oxford University Press 1998) at 56, which is an extension of data provided in Pitt M & Khandker S "The impact of group-based credit programs on poor households in Bangladesh: does the gender of participants matter?" (1998) 106(5) *Journal of Political Economy* 958. However, Yunus's claim, and some of the other important impact claims made in Pitt and Khandker's hugely influential original study, were later shown to be seriously problematic - see Roodman D & Morduch J "*The impact of microcredit on the poor in Bangladesh: Revisiting the evidence"* (2013) Financial Access Initiative Working Paper 06/2103. Available at http://www.financialaccess.org/sites/default/files/publications/the-impact-of-microcredit-on-the-poor-in-bangladesh-2013.pdf (accessed 10 April 2014); Duvendack M & Palmer-Jones R "Response to Chemin and to Pitt" (2012) 48(12) *Journal of Development Studies* 1892. Pointedly, as David Roodman explained, by dropping just *sixteen* outlier rich families from Pitt and Khandker's sample of 5,218 families, Roodman and Morduch showed that Pitt and Khandker's core finding of there being a positive impact from microcredit completely disappears. Available at http://www.cgdev.org/blog/bimodality-wild-latest-pitt-khandker (accessed 12 April 2014).

[8] For example, noted development economist, David Hulme, wrote that in the 1980s when he came across Yunus in the field, he found that Yunus "energetically promoted microenterprise credit as a panacea for poverty reduction (something that intensely annoyed me, as it was so wrong)" – see Hulme D *The story of the Grameen Bank: From subsidised microcredit to marketbased microfinance* BWPI Working Paper 60, Institute for Development Policy and Management, University of Manchester, (November 2008) at 6.

[9] Some of the most influential individuals in the early days of the microcredit movement included Maria Otero and Elizabeth Rhyne, then both associated with the Boston based microfinance advocacy and investment organisation ACCION (see Otero M & Rhyne E (eds) *The new world of microenterprise finance: Building healthy institutions for the poor* (London: IT Publications 1994)) and Marguerite Robinson attached to Harvard University at the time (see Robinson M *The microfinance revolution: Sustainable finance for the poor* (World Bank: Washington DC 2001).

In this "new world" of commercialised microcredit, the profit motive would ensure that MCIs would soon be pumping out massive volumes of microcredit, thus ensuring that every last poor individual could access as many microloans as they might wish for. MCIs would achieve this important outreach goal thanks to several new market freedoms that became quite fundamental to the operation of almost all major MCIs thereafter: the freedom to charge market based interest rates, the freedom for senior staff to reward themselves with Wall Street style salaries, bonuses and personal shareholdings in their own MCI (if not complete ownership of it), and the freedom to engage with the global investment community in order to obtain large volumes of wholesale funding (in addition to, or even in place of, deposits). Meanwhile, international donor community financial and technical support for the old Grameen Bank model of subsidised microcredit was quietly phased out almost everywhere. Finally, in 2001, Muhammad Yunus gave in to the mounting pressure, and his personal fear of being marginalised in an industry he had played a very central role in establishing, and took the required steps to convert the Grameen Bank itself to for-profit commercial respectability in a process known as the "Grameen II" project.[10]

By the early 2000s, the microcredit model had ascended to become the most high profile and well financed international development policy of all time. Summing up the feeling of the international development community at the time was Bernd Balkenhol, a senior ILO official then heading up its Social Finance Unit, who described microcredit as "<u>the</u> strategy for poverty reduction *par excellence*" (underlining in the original).[11] Importantly, Western governments were also major supporters, such as in Canada, where the then Cabinet Minister in charge of international development, Peter Mackay, famously described microcredit as "the vaccine for the pandemic of poverty".[12] Thanks also to rafts of celebrity endorsements,[13] microcredit quickly became the one international development policy that most ordinary members of the public had actually heard of and – crucially – very much liked and were individually willing to financially support.[14] Muhammad Yunus was even invited to participate in an episode of *The Simpsons*.[15]

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[10] Hulme (2008).

[11] Balkenhol B *The impact of microfinance on employment: What do we know?* Paper presented to the Global Microcredit Summit, Halifax, Canada, (12–16 November 2006).

[12] Mackay P "Statement by Peter Mackay, Cabinet Minister in the Canadian government responsible for International Development" (12 March 2006). Quoted in Roy A *Poverty capital: microfinance and the making of development* (New York: Routledge 2010) at 90.

[13] High profile supporters of microcredit come from Hollywood (Natalie Portman, Matt Damon), high profile political families (most notably Bill and Hilary Clinton), the music industry (Bono), entrepreneurs (Bill Gates through his foundation, Richard Branson, Pierre Omidyar, Michael Dell) and European and Middle Eastern Royalty (Queen Rania of Jordan, Queen Maxima of Holland).

[14] Witness the huge popularity of many so-called "social businesses", such as, Kiva, Zidisha and MyC4, that help individuals in the developed countries to fund individual microenterprises in developing countries, as well as the amazing recent growth in the number of university-based student led societies and initiatives in the USA and Europe that raise funds to support individual microenterprises abroad.

[15] See "*Loan-a Lisa*", *The Simpsons*, episode 466.

But always carefully hidden behind the obvious PR and heady celebration were the important political and ideological goals espoused by those supporting the microcredit industry.[16] Above all, thanks to the arrival of microcredit and through self-help and self-employment, the poor could now be forcibly repositioned into accepting that they were once more *individually* responsible for lifting themselves and their families out of poverty. The poor need no longer reject capitalism and agitate for some alternative to it, or be envious of, or protest or take up arms against its main beneficiaries, because capitalism can now work for them too: *they can now get their own small "piece of the action"*. This was the supremely ideological "bringing capitalism down to the poor" message that began to be pushed out by the growing number of high profile neoliberals and neoliberal oriented international development institutions that became the most dedicated supporters of the microcredit model. One of the most notable early supporters of microcredit, for example, was arch neo-liberal Hernando de Soto. De Soto famously claimed that the poor were all potential entrepreneurs and that thanks to extensive deregulation and more microcredit their poverty would very quickly come to an end.[17] Alongside Muhammad Yunus's tireless promotion of the microcredit model, De Soto's similarly uplifting (though ultimately quite mistaken[18]) message to the poor was to prove hugely influential in shaping the view of the international development community on the right way to address poverty. The overall result, as David Harvey pointedly concluded,[19] was that the international development community had wrongfully bought into

> The wondrous fiction that the informal sector of social reproduction which dominates in many cities of the developing world is in fact a seething mass of micro-enterprises that need only a dose of microfinance (at usurious rates of interest pocketed at the end of the trail by major financial institutions) in order to become fully fledged card-carrying members of the capitalist class.

In a return to pre-modern times, important "collective capabilities" and forms of state agency that history convincingly shows have been of most benefit in eliminating poverty,[20] could now be dismantled even further than neo-liberals had ever dreamed might be possible in the heady 1980s. Using nothing more than individual initiative, hard work and determination, aided by a little microfinance, escaping poverty was now once again all down to the individual herself. Nothing else need be done to assist the poor.

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[16] Bateman M *Why doesn't microfinance work? The destructive rise of local neoliberalism* (London: Zed Books 2010) at 154-166: see also Bateman M & Maclean K (eds) *Seduced and betrayed: Exposing the Contemporary Microfinance Phenomenon* (Santa Fe, NM: SAR Press forthcoming).

[17] De Soto H *El otro sendero* (Lima: Editorial El Barranco 1986).

[18] In De Soto's own Latin America, the informal microenterprise sector doubled in size over the 1990s, but so did poverty levels in almost exactly the same locations (see the discussion in Bateman M "*La Era de las microfinanzas: Destruyendo las economías desde abajo*" *Ola Financiera*, No 15, May-August 2013). Available at http://www.olafinanciera.unam.mx/new_web/15/index.html (accessed 21 February 2014).

[19] Harvey D *Seventeen contradictions and the end of capitalism* (London: Profile Books 2014) at 186.

[20] See for example the arguments put forward in Chang H-J *Kicking away the ladder – Development strategy in historical perspective* (London: Anthem Press 2002); Chang H-J *Bad samaritans: Rich nations, poor policies and the threat to the developing world* (London: Random House 2007): Chang H-J *23 things they don't tell you about Capitalism* (London: Allen Lane 2010).

2.2 Hubris turns to nemesis

Starting in 2007, however, the microcredit industry was rocked by a succession of events that combined to destroy pretty much the entire public case that had been carefully, but largely artificially, built up in its favour. In this year we saw the first of what was to become a whole series of financial scandals to erupt in the microcredit industry, scandals that appeared to perfectly illuminate the real purpose and programmatic impact of microcredit far more than any uplifting exhortation or economic theorising could do. This first scandal followed the now infamous Initial Public Offering (IPO) of Mexico's largest microcredit bank, Banco Compartamos. This was an event that was noteworthy not because it was able to demonstrate that poverty had been reduced in the community – there remains absolutely no proof of this whatsoever[21] - but because the IPO process unintentionally exposed to the public some quite spectacular and wilful profiteering by Compartamos's own senior management and its external investors,[22] and even by the US based advisors involved.[23] As a result of many more such scandals, notably also in India with regard to self-declared "poverty activist" Dr Vikram Akula,[24] the commercial microcredit model began to be challenged by its own long-time advocates. Their anger was directed at the hard-nosed Wall Street types taking over the microcredit industry in search of enormous wealth for themselves

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[21] A recent impact evaluation of Banco Compartamos led by Dean Karlan of Yale University, a noted supporter of microcredit, could only come up with very weak evidence in support of a positive impact from Compartamos's activities (Angelucci M, Karlan D & Zinman J *Win some lose some? Evidence from a randomized microcredit program placement experiment by Compartamos Banco* (Yale University, May 2013). Moreover, the research team could only achieve this tepid result after deliberately choosing an evaluation methodology - the Randomised Control Trial (RCT) - that is patently unsuitable for such applications because it cannot factor into the analysis many of the most important downsides to the microcredit model. See Bateman M "Latin America's tragic engagement with microcredit" *CEPR Blog* 23 July 2013). Available at http://www.cepr.net/index.php/blogs/the-americas-blog/latin-americas-tragic-engagement-with-microcredit (accessed 28 May 2014). See also Sinclair H "Disguised mediocrity – the quest for POSITIVE impact results at Compartamos" *Confessions of a microfinance heretic – blog,* (27 August 2013). Available at http://blog.microfinancetransparency.com/disguised-mediocrity-the-quest-for-positive-impact-results-at-compartamos/ (accessed 25 May 2014).

[22] Bateman (2010) at 142-152.

[23] In her normal salaried position as President and CEO of Boston-based ACCIÓN, one of the main investors in Compartamos, it was part of Maria Otero's role to advise Compartamos officials in the run-up to their IPO. For her efforts, Otero was generously rewarded with a million dollar bonus in 2008, and then a further USD 550,000 bonus in 2009 just prior to leaving ACCIÓN to join the first administration of US President Barack Obama as Under-Secretary of State for Democracy and Global Affairs - see Sinclair H *Confessions of a microfinance heretic: How microlending lost its way and betrayed the poor* (San Francisco: Berrett-Koehler 2012) at 75.

[24] Akula's initial fame was based on his founding of SKS, which was soon to become India's largest and most profitable MCI, an achievement that, among other things, led in 2006 to Akula becoming one of *Time* magazine's 100 most influential individuals in the world. However, after SKS and Akula very much led the charge to expand the microcredit sector in the Indian state of Andhra Pradesh, and after receiving nearly USD 14 million when SKS underwent its IPO, as well as rewarding himself before this with a spectacular annual salary, enough to make him one of India's highest paid CEOs, in 2010 the Andhra Pradesh microfinance sector dramatically collapsed. Akula then became better known as the one individual around the world most associated with the greed, excess and unethical behaviour that began to mark out the global microfinance sector in the new millennium – see Bateman M "How lending to the poor began, grew, and almost destroyed a generation in India" (2012) 43(6) *Development and Change* 1385.

and their investors.[25] The sour reality that they had to face up to was that microcredit had morphed into just another technique, *but this time very much socially validated*, of transferring value from the poorest individuals and communities at the bottom of the pyramid into the hands of entrepreneurial and financial elites at the top.

Importantly, an attack also began on the fundamental economic principles underpinning the microcredit model which, notwithstanding the enormous problems they have faced in actual practice, many microcredit advocates and academic economists still assumed provide the most important justification for their continuing support of the 'pure' microcredit model. Economists have been drawn to the fact that the link between local financial institutions and expansion of the informal sector remains under-researched,[26] a somewhat surprising fact given that (very much thanks to microcredit) developing country economies are increasingly composed of simple unproductive "buy cheap, sell dear" informal microenterprises.[27] In this context, a number of insightful analysts, such as, Ben Rogaly,[28] and later Julia Elyachar,[29] challenged the important claims made by those promoting the microcredit model. Calls subsequently went out to reform some operational aspects of microcredit in order to make it more developmental, pro-poor and gender empowering.

A number of heterodox economists, however, dismissed the possibility of reforming the microcredit model and began to develop a much more fundamental challenge to its economic and social rationale. According to this way of thinking,[30] microcredit should really be seen as an "anti-development" intervention, one that *programmatically* disadvantages the poor into the longer run. Key issues raised here, among many, include the de-industrialising, informalising, disconnecting and

[25] Dichter T & Harper M (eds) *What's wrong with microfinance?* (London: Practical Action Publishers 2007); Harper M "The commercialisation of microfinance: resolution or extension of poverty?" in: Bateman M (ed) *Confronting microfinance: Undermining sustainable development* (Sterling, VA: Kumarian Press 2011) at 49-63; Sinclair (2012).

[26] See Beck T, Lin C & Ma Y "Why do firms evade taxes? The role of information sharing and financial sector outreach." Annual Bank Conference on Development Economics - Accountability and transparency for Development, 7 – 8 May 2012, Washington DC.

[27] As are the developed country economies, too, thanks to the Great Recession – see Fairlie, R "Entrepreneurship, economic conditions, and the Great Recession" (2013) 22(2) *Journal of Economics & Management Strategy* 207.

[28] Rogaly B "Microfinance evangelism, 'Destitute women', and the heard selling of a new anti-poverty formula" (1996) 6(2) *Development in Practice* at 100.

[29] Elyachar J *Markets of dispossession: NGOs, economic development, and the State in Cairo* (Durham, NC: Duke University Press Books 2005).

[30] See Bateman M '"New wave' micro-finance institutions in South-East Europe: Towards a more realistic assessment of impact" (2003) 14(3) *Small Enterprise Development* 56; Bateman M "Deindustrialisation and social disintegration in Bosnia' in: Dichter & Harper (2007) at 207-223; Bateman (2010); Bateman (2013); Bateman M "*The rise and fall of Muhammad Yunus and the microcredit model*" International Development Studies, Working Paper No 1, (St Mary's University, Halifax, Canada, January 2014). Available at http://www.smu.ca/webfiles/BATEMANIDSWP.pdf; Chang (2010) at 157-167; Bateman M & Chang H-J "Microfinance and the illusion of development: from Hubris to Nemesis in Thirty Years" (2012) 1(1) *World Economic Review* 13.

primitivising[31] effects of microcredit, which have been more than amply demonstrated in all of the countries, regions and localities where the microcredit model has gained an important foothold.

For a very good illustration of the heterodox argument being made here one can usefully start with the important case of Latin America. In a high profile publication released by IDB in 2010,[32] it is pointed out that for a long time (at least until the late 1990s) the continent was trapped in poverty and underdevelopment. The principle reason for this, according to the IDB, was because the continent's private financial institutions channelled far too much of the available financial resources into low productivity informal microenterprises and self-employment ventures, and far too little into more productive formal small, medium and large enterprises. Latin America's enterprise sector was thus being helped to "dumb down", not "scale up" into a much more productive structure capable of improving livings standards, especially for the poor, in the longer run. This allocative inefficiency was discussed very graphically by the IDB. The IDB pointedly notes that over the last twenty years Latin America's financial institutions had achieved nothing more than "the pulverisation of economic activity into millions of tiny enterprises with low productivity".[33] Informal microenterprises and self-employment ventures are seen by the IDB as by far the most inefficient enterprise structures, and their expansion had led to a very negative outcome in Latin America because "resources are (then) locked up in very small – often one-person – firms, of very low productivity".[34] The IDB also repeatedly denounces the role played by informality, which all too often ends up "shielding small firms – the vast majority of which are very inefficient – from the competition of better, more productive business models".[35] In a nutshell, and albeit indirectly, the IDB effectively blew out of the water the entire case for intermediating scarce financial resources into informal microenterprises and self-employment ventures, and so also the entire case for the microcredit model.

Latin America is certainly not the only problematic area in this regard. Similar adverse experiences have been extensively documented in other countries of late. In post-war Bosnia, for example,[36] the widely celebrated microfinance model helped to precipitate a range of adverse economic and social outcomes that have helped to preclude the establishment of a sustainable reconstruction and development trajectory. First, almost no sustainable jobs were created. Thanks to microcredit waves of tiny

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31 Primitivisation might be defined as the reversion to pre-modern inefficient forms of industrial and agricultural organisation that realise no economies of scale, have no technological spin-offs, generate few innovations, and create few synergies and efficiency enhancing linkages.

32 Inter-American Development Bank *The age of productivity: Transforming economies from the bottom Up* (Washington DC: IDB 2010)

33 Inter-American Development Bank (2010) at 6.

34 Inter-American Development Bank (2010) at 69.

35 Inter-American Development Bank (2010) at 67.

36 See Bateman M, Sinković D & Škare M "*The contribution of the microfinance model to Bosnia's post-war reconstruction and development: How to destroy an economy and society without really trying*" (2012) Working Paper No. 36 Austrian Research Foundation for International Development (ÖFSE). Available at http://www.oefse.at/Downloads/publikationen/WP36_microfinance.pdf (accessed 23 July 2014).

microenterprises were indeed able to enter local markets in Bosnia, but then just as quickly almost as many of them collapsed, including many struggling incumbent enterprises facing this new microcredit induced competition. This failure issue was especially prevalent with regard to the many microenterprises undertaken by women in poverty.[37] Notably, also, because the only financial offer effectively available to new start entrepreneurs was microcredit, and because microcredit is entirely unsuitable for anything other than rapid turnover operations that can add value very quickly, Bosnia's large military industrial sector was almost entirely passed over as a source of innovative and technology based new start enterprises. This was an enormous waste of an important endowment of industrial skills, knowledge and institutional capacity, an endowment that virtually every other developing country today is desperately attempting to create and maintain.[38] Finally, massive individual over-indebtedness of the poor clients, and even those who simply stood as guarantors for a microloan, became a hugely disfiguring and disruptive feature right across Bosnia. This over-indebtedness situation arose because its leading MCIs had embarked on a mission to expand their operations as rapidly as possible, not so much with a view to benefitting Bosnia's poor and unemployed, but largely in order to quickly generate the financial surpluses that could underpin the spectacular compensation packages self-awarded to senior managers.

In India, the microcredit sector has helped precipitate one of the country's most serious structural problems, the so-called "missing middle".[39] The "missing middle" can be defined as the gap in an overall production structure that exists between survivalist and hugely unproductive informal microenterprises, on the one hand, and the small number of efficient private and State enterprises, on the other.[40] In 2005-6, the proportion of India's workers in the informal sector in total manufacturing was 80 per cent, the highest figure for a large high growth country.[41] In India's case, one of the factors accounting for the rise of this 'missing middle' factor is the increasing diversion of capital into ultra-low productivity "survivalist" enterprises. The popularity and profitability of microcredit is such that India's commercial banks have chosen (and have sometimes been forced by the Indian government, too) to invest their deposits with high profit MCIs that, in turn, reward them with very much higher and safer returns than they might otherwise expect from directly supporting India's Small and Medium Enterprises (SME) sector.

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37 See Bateman M & Sinković D "Bosnia's post-conflict microfinance experiment: A new Balkan tragedy" in: Bateman M and Maclean K (forthcoming).

38 Bateman (2007).

39 See Karnani A "Undermining the chances of sustainable development in India with microfinance" in Bateman M (2011) at 83-95; Karnani A *Fighting poverty together: Rethinking strategies for business, governments, and civil society to reduce poverty* (New York: Palgrave MacMillan 2011).

40 See also 'The missing middle', Centre for International Development, Harvard University. Available at http://www.hks.harvard.edu/centers/cid/programs/entrepreneurial-finance-lab-research-initiative/the-missing-middle (accessed 20 July 2014).

41 Vandemoortele M, Bird K, Du Toit A, Liu M, Sen K & Veras Soares F (eds) *Building blocks for equitable growth: Lessons from the BRICS*, ODI Working Paper 365 (London: ODI 2013) at 8.

We should note also that researchers in Bangladesh have found that the same "missing middle" dynamic exists in that country and for the same microcredit sector-driven reasons as in India.[42] Growth oriented SMEs are effectively ignored by the microcredit dominated financial system in Bangladesh, while informal microenterprises and ordinary households have in recent years been badgered into taking out far too many microloans, including multiple microloans per household. The end result of this micro lending spree has been a massive individual over-indebtedness problem, one that very much continues to haunt the microfinance industry in that country today.[43] A similar adverse dynamic also exists in microcredit saturated Cambodia, where the banking system is massively geared up to microlending and (at least until very recently) has almost entirely stayed away from SME lending.[44]

The fundamental structural problem created by this adverse financial intermediation process comes through very clearly in the pioneering work of Erik Reinert. As Rienert shows,[45] any development strategy that is substantially based on a programmed expansion of diminishing returns activities – informal microenterprises and self-employment ventures - cannot but inexorably lead on to what he calls "retrogression" and "primitivisation". That is, important scale economies are lost, technologies suitable at certain volumes of activity are entirely abandoned, important efficiency enhancing vertical and horizontal inter-enterprise connections are inoperable, and many other similar problems arise. Disaster ultimately ensues, as history abundantly shows. As Reinert sums up:[46]

> Systems based on increasing returns, synergies and systematic effects all require a critical mass; the need for scale and volume creates a 'minimum efficient size'. When the process of expansion is put in reverse and the necessary mass and scale disappears the system will collapse.

It is thus not by coincidence that this general primitivisation and retrogression dynamic described by Reinert is *exactly* what we are seeing in all of those locations – national, regional and local – where the microcredit model has gained the strongest foothold.

Crucially, this wider heterodox argument against microcredit has of late received important support in more mainstream circles, not least thanks to a high profile systematic review of all the accumulated evidence purporting to show a positive impact.[47] Although initially conceived by the UK government's aid arm, the DFID, as an output that would provide support for its microcredit programs, which were still being implemented in spite of the rising headwind of criticism, the review team actually made

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42 Department for International Development, *The Road to prosperity through growth, jobs and skills* (Dhaka: Department for International Development Bangladesh 2008).

43 Chen G & Rutherford S "A microcredit crisis averted: The case of Bangladesh" *Focus Note* 87 (Washington, D.C: CGAP 2013).

44 Bateman (2014) at 16-17.

45 Reinert E *How rich countries became rich, and why poor countries stay poor* (London: Constable 2007).

46 Reinert (2007) at 171.

47 Duvendack M, Palmer-Jones R, Copestake J, Hooper L, Loke Y & Rao N What is the evidence of the impact of microfinance on the well-being of poor people? (London: EPPI-Centre, Social Science Research Unit, Institute of Education, University of London 2011).

things much worse for the DFID. The review team could find no solid evidence whatsoever to support the many long-standing positive poverty reduction and development claims made on behalf of the microcredit model. Centrally, the evaluation team found that all the previous impact evaluations that came to broadly positive conclusions regarding microcredit, only managed to do so because they were biased, incomplete, or else used quite inappropriate methodologies.[48] The overarching conclusion of the systematic review was a major blow to the microcredit industry, and to the DFID especially, stating that the "*[c]urrent enthusiasm* (for microcredit) *is built on…foundations of sand*". [49]

Finally, and further quite dramatic confirmation of the negative prognosis of many heterodox economists, those countries and regions previously held up by the microcredit industry as the "star performers", one by one began to collapse in a market-driven "boom to bust" scenario. For a number of obvious reasons, these "boom to bust" episodes were hugely destructive to the countries concerned. Starting first in pioneering Bolivia in 1999-2000,[50] "boom to bust" scenarios then played out from 2008-9 onwards in Nicaragua, Morocco and Pakistan.[51] Bosnia's massively celebrated microcredit sector encountered its own 'boom-to-bust' in 2009.[52] In 2010 the microcredit industry was then convulsed by the largest and most destructive market driven "boom to bust" episode to date, in Andhra Pradesh state in India.[53]

Ominously, a number of other countries also stand on the precipice of a meltdown today. This list is headed up by Mexico, which by the summer of 2014 appeared to be on the very edge of a complete meltdown.[54] But also on the list would be Sri Lanka, Nigeria, Nepal, Kyrgyzstan, Georgia, Lebanon, Cambodia, Ghana, Uganda and Colombia. As this article centrally shows,[55] South Africa must be included in the category of countries at serious risk of a major "microcredit meltdown". Then there is also Peru, a country where a simply staggering USD 11 billion of microloans have to date been disbursed among less than four million poor clients, and where a sharp contraction - possibly rapid, but also just possibly a controlled contraction thanks to

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[48] Of course, because a large number of the earliest impact evaluations were undertaken by the MCIs themselves and/or by dedicated microfinance supporters and well paid academic consultants looking for more work, there was an inevitable tendency to deliberately exaggerate and misrepresent the impact in order to keep the financial support flowing into the microcredit sector and MCIs.

[49] Duvendack *et al* (2011) at 75.

[50] Rhyne E *Mainstreaming microfinance: How lending to the poor began, grew, and came of age in Bolivia* (West Hartford, CT: Kumarian Press 2001).

[51] Schicks J & Rosenberg R "Too much microcredit? A survey of the evidence on over-indebtedness?" Occasional Paper 19 (Washington, D.C.: World Bank - CGAP, September 2011).

[52] Bateman, Sinković & Škare (2012) at 10.

[53] Arunachalam R *The journey of Indian micro-finance: Lessons for the future* (Chennai: Aapti Publications 2011); Bateman (2012).

[54] For example, see Rozas D "Mexico: Deja vu all over again?" European Microfinance Platform, 30 May 2014. Available at http://www.e-mfp.eu/blog/mexico-deja-vu-all-over-again (accessed 2 June 2014.

[55] See also the excellent and up-to-date discussion by James D "'Deeper into a hole?' Borrowing and lending in South Africa" (2014) 55 Supplement *Current Anthropology* (9 August).

State intervention and support – is already underway.[56] Crucially, it cannot be emphasised enough that in *none* of these country examples do we find any solid evidence that poverty has been meaningfully and causatively reduced as a result of the massive expansion in the supply of microcredit.

At one time, the home of microcredit – Bangladesh - was also very rapidly heading towards the "boom to bust" category. However, for reasons we are not yet quite clear about,[57] it seems that sometime around 2010 the CEOs of the main MCIs in Bangladesh agreed to get together and pull back from the edge.[58] Expansion plans were shelved, some MCIs pruned the number of units they had, and aggressive bonus systems primarily based on bringing in new clients were scaled down. Although Bangladesh's microcredit sector still remains in some considerable danger, thanks to its dramatic over-expansion prior to 2010, and it is still unable to point to any solid evidence that microcredit has imparted a positive long-term impact in the country,[59] the genuine fears expressed only a few years ago of there being a total collapse in the market – "a coming train wreck" as the head of one MCI (ASA) put it – have, for now anyway, abated.

[56] For example, see Sinclair H "What are some of the signs of a looming microfinance crisis?" 8 February (2014) http://blog.microfinancetransparency.com/what-are-some-of-the-signs-of-a-looming-microfinance-crisis/ (accessed 10 April 2014).

[57] There remains somewhat of a silence about what exactly happened here and why the main MFIs came to an agreement in Bangladesh to willingly halt their expansion and effectively agree to stop competing and to share the market among them. My own feeling, based on some informal contact with financial analysts working in Dhaka, is that the international community put serious pressure on the main MFIs to "get their act together" before it was too late. For sure, there was a well-founded fear in the international donor community that an Andhra Pradesh-style collapse of the microcredit sector in Bangladesh would terminally discredit the concept, and also further discredit the role of markets in development policy. So intervening to prevent this market driven outcome would have made a lot of sense from their point of view.

[58] See Chen & Rutherford (2013) at 9.

[59] In spite of the problems raised in his earlier publications with Pitt (Pitt & Khandker [1998]), Khandker returned in 2014 to the issue of microfinance impact in Bangladesh. In a new paper (Khandker S & Samad H *Are microcredit participants in Bangladesh trapped in poverty and debt?* World Bank Policy Research Working Paper 6404 (Washington DC: World Bank 2013) which was based yet again on the long-running World Bank-supported survey of microcredit in Bangladesh, Khandker claims that he has finally found the solid evidence of positive impact he has been looking for. However, as in all of the previous outputs forthcoming from the same World Bank project, it turns out that the methodology and data had yet again been carefully "managed" in order to come to the required upbeat conclusion. In particular, the study continued to avoid factoring in the important long-term negative consequences of microenterprise exit and displacement. The study also refused to discuss the longer-run impact (opportunity cost) of programmatically creating local economies in Bangladesh that are dominated by informal microenterprises, as opposed to, say, vigorously promoting more productive formal SMEs instead, as was the radically different policy objective in neighbouring – and pointedly more economically successful - South Korea, Taiwan, Malaysia, Thailand, China and Vietnam. See Bateman M "The art of pointless and misleading microcredit impact evaluations" Governance across Borders (29 May 2013). Available at http://governancexborders.com/2013/05/29/the-art-of-pointless-and-misleading-microcredit-impact-evaluations/ (accessed 29 July 29 2014); see also Roodman D "Shoddy microcredit impact reporting in *Economist*" David Roodman's Blog, 17 April 17 2014. Available at http://davidroodman.com/blog/2014/04/17/shoddy-microcredit-impact-reporting-in-economist/ (accessed on 29 July 2014); Rozas D "Measuring success in microfinance" European Microfinance Platform, 25 April 2014). Available at http://www.e-mfp.eu/blog/measuring-success-microfinance (accessed 29 July 2014).

Although initially challenged by the microcredit industry, by 2013/2014 almost all of the core arguments put forward, for example, by such as Bateman[60] and Bateman and Chang[61] were being much more widely accepted by mainstream economists,[62] and pointedly within the microfinance industry itself.[63] In fact, it is no over-statement to say that the microcredit concept today is in an existential crisis.[64]

3 OUTLINES OF A "DEVELOPMENTAL" LOCAL FINACIAL SYTEM

3.1 The "right" and the "wrong" enterprises

Prior to the spectacular arrival of the microcredit model in the 1980s, significant progress had already been made in identifying what combination of institutions, organizations and regulations constitute an effective, or "developmental", local financial system. This section provides a very brief outline of what we know from economic history. The aim of the section is to allow for a comparison of this broadly successful "developmental" model of local finance to what I argue is the manifestly failing market driven microcredit model.

Economists have recently paid more attention to the financial system and its impact on growth and development. After a long time working under the assumption that the financial sector has little to do with economic growth, mainstream researchers in the 1990s began to challenge this view. Beginning with the important work of King and Levine,[65] a large literature began to emerge demonstrating that the depth and breadth of the financial sector actually plays a crucially important role in promoting growth and development. An optimally functioning financial sector achieves this goal by

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[60] Bateman (2010).

[61] Bateman & Chang (2012).

[62] See, for example, Altman D "Please do not teach this woman to fish" *Foreign Policy* 9 June 2014). http://www.foreignpolicy.com/articles/2014/06/09/please_do_not_teach_this_woman_to_fish_microfinance_kiva_entrepreneurship (accessed 24 July 2014).

[63] For example, in 2013 Dr Claus-Peter Zeitinger, one of the world's most respected microcredit pioneers and founder of the largest microfinance bank in the world, the Pro-Credit Bank Group, wrote in a review that he had had an epiphany when he read Bateman's 2010 book because it was such an accurate reflection of the many serious problems he (Zietinger) had encountered in the nearly 30 years he had spent working in the microcredit industry. Bateman was then invited to the Pro-Credit Bank AGM in Frankfurt in May 2013 in order to give a keynote presentation in front of 200 Pro-Credit senior employees and then to debate with Dr Zeitinger as to why microcredit failed and what to do about it. Pro-Credit Bank also ordered 500 copies of Bateman's 2010 book for use as a teaching aid in their three training centres in Germany, Macedonia and Colombia. Pro-Credit Bank's future strategy is to fully exit the microcredit sector and establish itself as one of the most reputable banks providing quality financial services to the SME sector. See "Why doesn't microfinance work? The destructive rise of local neoliberalism' – Comments by Dr. Claus-Peter Zeitinger, initiator and founding shareholder of the ProCredit group', Zed Books Blog, 6 June 2013. Available at http://zed-books.blogspot.com/2013/06/why-doesnt-microfinance-work_6.html (accessed 6 April 2014).

[64] Bateman & Maclean (forthcoming).

[65] King R & Levine R "Finance, entrepreneurship, and growth: Theory and evidence" (1993) 32(3) *Journal of Monetary Economics* 513; also King R & Levine R "Finance and growth: Schumpeter might be right" (1993) 108(3) *Quarterly Journal of Economics* 717.

increasing the quantity of finance available for enterprise development and the quality of investments made thereafter.

Going further, it is also widely accepted that the financial sector can most efficiently allocate scarce financial resources if this takes place on the basis of the (potentially) most productive enterprises being encouraged to enter and the least productive enterprises discouraged/forced to exit.[66] Functioning enterprises should also be able to grow fast through accessing more capital which, crucially, allows them to absorb market share from the least productive enterprises, which should be encouraged to exit. It is widely accepted that these dynamic processes of selection and re-allocation have driven growth in the developed countries, especially in the USA, Japan and in the European Union (EU).[67] However, these processes are much less evident in the developing countries, where even the most productive enterprises are on average very much smaller than in developed countries in terms of their share of the local market, total turnover and employment.

However, while usefully illuminating as to the causes of long-term development and growth, and the policy requirements required, for many development economists these important advances in our understanding of the financial system were still partial and incomplete because they actually had very little to say in terms of explaining most *actual* historical episodes of rapid development, growth and poverty reduction. The response from a number of heterodox development economists to this omission came with the idea of there being a *developmentally* efficient financial system, one that is far removed from the type of market driven financial system celebrated in neo-classical textbooks, and also much more sophisticated and proactive than the revised version put forward by, for example, King and Levine.

A developmentally efficient financial system is one that not just *increases* the quantity and quality of capital available for investment in the enterprise sector, which, King and Levine posited, was very important, but one that also possesses particular institutions, organisations and regulatory structures that are capable of very proactively "guiding" that capital into the "right" growth oriented enterprises. Defining the institutions and organisations that can successfully "guide" capital, and also what these "right" enterprises were, formed much of the foundation of the seminal work of the "developmental statist" school derived from the path-breaking work of, for example, Johnson, Amsden, Wade, Chang, Evans, Lall and Weiss.[68] A further important

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[66] A good discussion would be Foster L, Haltiwanger J & Syverson C "Reallocation, firm turnover, and efficiency: Selection on productivity or profitability?" (2008) 98 *American Economic Review* 394.

[67] Many EU policies, such as, notably the Single Market, have been explicitly designed with a view to stimulating the benefits of such selection and re-allocation processes.

[68] Key texts in this heterodox "developmental statist" literature would include; Johnson C *MITI and the Japanese miracle: The growth of industrial policy, 1925-1975* (Stanford, CT: Stanford University Press 1982); Amsden A *Asia's next giant: South Korea and late industrialization* (Oxford University Press, Oxford and New York 1989); Amsden, A *The rise of 'the rest': Challenges to the West from late-industrializing economies* (Oxford: Oxford University Press 2001); Amsden A *Escape from empire: The Developing World's journey through heaven and hell* (Cambridge, Massachusetts: MIT Press 2007); Wade R *Governing the market*, Princeton (NJ: Princeton University Press 1990); Chang H-J 2002; Chang H-J *Globalisation, economic development and the role of the state* (London and Penang: Zed Books and Third World Network

contribution here in terms of defining the "right" enterprises was also made by Nelson and Winter in their theory of evolutionary change.[69] They showed that only particular types of enterprise drive growth and economic development, namely those big enough, flexible enough and sophisticated enough to be able to take part in a process of increasing technological and institutional capability upgrading and continuous learning.

If we distil the historical evidence down to a set of rough indicators, we would find that the "right" type of enterprise, then, would be small, medium or large enterprises that have all or some of the following characteristics:

- are formally registered and operating according to all legal requirements: among other things, formality would allow for access to larger quantities of low cost capital, participation in State sponsored programs of technology transfer, an increased ability to undertake formal subcontracting work with State and private enterprises, a reduced chance of being exposed to criminality, and the ability to attract the best employees.
- are operating at, or well above, the minimum efficient scale: this would allow for the attainment of the lowest cost of production per unit;
- are as much as possible operating on the technology frontier: this would allow for the best possible chance of producing an output that is of the highest quality, technically sophisticated, and contains the latest innovations.
- are innovation and skills driven rather than (just) low labour cost-driven; this would help to ensure that an enterprise embarks on a socially-preferable trajectory that has important feedback effects in terms of developing solidarity and trust and in justifying labour saving capital investments.
- are horizontally – clusters, networks – and vertically – subcontracting, supply chains, public procurement – productively interconnected with other organisations: this would ensure that important "collective economies of scale" might be realised in individual enterprises, and crucial knowledge acquisition from other enterprises in the supply chain would be possible;
- are able to continually facilitate the creation of new organisational routines and capabilities: this would ensure that the enterprise increases its all-round ability to sustainably grow while reducing costs.

Meanwhile, others working in the field of local economic and enterprise development have also made important contributions in helping us to define what is a "wrong" enterprise, one that we must avoid and not waste scarce funds in supporting. Of

2003); Chang H-J. *The East Asian development experience: The miracle, the crisis and the future* (London: Zed Books and Third World Network 2006); Chang (2007); Chang (2010); Evans P *Embedded autonomy: States and industrial transformation* (Princeton, NJ: Princeton University Press 1995); Lall S *Learning from the Asian Tigers: Studies in technology and industrial policy* (MacMillan Press, London 1996); Weiss L *The myth of the powerless State: Governing the economy in the global era* (Cambridge, UK: Polity Press 1998).

[69] Nelson R & Winter S *An evolutionary theory of economic change* (Cambridge, MA: Belknap Press/Harvard University Press 1982).

particular importance to the analysis here are those who have pointed out why informal microenterprises and self-employment ventures are "anti-developmental" and growth impeding. A notable early contribution was made by William Baumol,[70] who provided a useful typology of enterprises and entrepreneurship, including those forms that he saw as ultimately destructive. David Storey then provided substantial support for the argument that stimulating the process of new entry per se is generally only of value to society when it involves that small number of enterprises possessing growth potential.[71] Otherwise, valuable resources are wasted on creating nothing more than an ultra-competitive local environment in which the desperate scrabble for survival between simple microenterprises leads to a zero-sum outcome. Among other things, such an environment is marked out by powerful exit, and job and income displacement, effects. The combination of these generally means that virtually no *net* permanent jobs and no average increases in income are registered as a result of a programmed stimulation of new entry in microenterprises.[72] In the recession hit UK of the late 1980s and early 1990s, for example, because of just such exit and displacement effects, the Thatcher government's self-employment and microenterprise development programs created almost no additional jobs,[73] as was the case with similar programs elsewhere in Europe,[74] while the turnovers, incomes and profits realised by *incumbent* microenterprises declined thanks to the artificially stimulated increase in competition.[75] Moreover, and largely hidden from view or simply not reported, many individuals failing in their attempt to establish a new microenterprise also ended up losing long-held assets offered as collateral, such as, housing, land, and motor vehicles, and which pointedly included any redundancy monies they might have received prior to becoming self-employed. A large number of individuals unsuited to entrepreneurship were thus plunged into even deeper poverty, debt and insecurity than ever before.

More recently, the related myth that the informal microenterprise sector serves as the foundation, or "breeding ground", for larger and higher productivity SMEs, has

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[70] Baumol W "Entrepreneurship: Productive, unproductive, and destructive" (1990) 98(5) *Journal of Political Economy* 893.

[71] Storey D *Entrepreneurship and the new firm* (London: Routledge 1982); Storey D *Should we abandon support to start-up businesses?* Working Paper No 11, SME Centre, University of Warwick (1993); Storey D *Understanding the Small Business Sector* (London: MacMillan 1994); Storey D & Johnson S *Job generation and labour market change* (London: MacMillan 1987).

[72] It should also be pointed out that there are generally no positive Schumpeterian 'creative destruction' effects registered here, since this process generally requires a background of reasonably sophisticated enterprises whose exit can pass over something of real value - capital equipment, skills, knowledge, etc - to the remaining market participants. Informal microenterprises that collapse generally exit with no such impact – see Bateman (2010) at 65

[73] Hasluck C *The displacement effects of the enterprise allowance scheme: A local labour market study*, (Coventry: Institute for Employment Research, University of Warwick 1990).

[74] Felstead A & Leighton P "Issues, themes and reflections on the 'Enterprise Culture'" in Leighton P & Felstead A (eds) *The new entrepreneurs: Self-employment and small business in Europe* (London: Kogan Page 1992) 15 - 38 at 31.

[75] Not surprisingly, the Thatcher government's microenterprise programme in the 1980s – the Enterprise Allowance Scheme, (EAS) - was often strongly opposed by incumbent microenterprises and the self-employed through membership of their local Chamber of Commerce.

been comprehensively disproved.[76] Nightingale and Coad very usefully summarise some of the key issues raised by them and other authors, and conclude that "[a]cross the board policy enthusiasm for entrepreneurial start-ups, no matter their quality, might be seen as another policy fad." [77] We might roughly define the 'wrong' type of enterprises as those that:

- are typically simple microenterprises or one-person self-employment ventures: meaning that the microenterprise will have very little impact;
- are unregistered or, worse, illegal: meaning that the microenterprise is susceptible to criminality and cannot access low-cost capital from formal sources, while the universal association with no tax contribution, low wages and poor and insecure working conditions serves to undermine the functioning of local government and the local labour market;
- are in possession of no functional links to other local enterprises (subcontracting, clustering) or to the community (e.g., taxation, adherence to health and safety legislation): meaning that important "collective economies of scale" are impossible, and there is no real chance of any inter-enterprise learning;
- are operating at below the minimum efficient scale: meaning that the per unit costs will be relatively high for the goods or services produced, thus limiting demand and the ability to successfully compete with larger enterprises;
- are low/no technology based: meaning that there is little chance to improve the overall quality of the process and product, or promote technology transfer and knowledge acquisition and learning in the local economy;
- are driven more by low wages rather than innovation or skills upgrading: meaning that there will be high labour turnover, poor labour relations, and little incentive to replace some labour with machinery and equipment;
- are in possession of almost no concern for the environment: meaning that they will deplete local resources and destroy the local environment for future generations;
- are very often petty trade based: meaning that the typical externality benefits that come from industrial and manufacturing enterprise development are not realised.

Combining the two concepts of the "right" and the "wrong" enterprises a local financial system should/should not ideally support, we might usefully define a "developmental"

[76] The most notable contributions here are La Porta R & Shleifer A *The unofficial economy and economic development* National Bureau of Economic Research Working Paper, No 14520 (Washington DC: NBER 2008); Shane S "Why encouraging more people to become entrepreneurs is bad public policy" (2009) 33 *Small Business Economics* 141.

[77] Nightingale P & Coad A "Muppets and gazelles: political and methodological biases in entrepreneurship research" (2014) 23(1) *Industrial and Corporate Change* 136.

financial system as one that can most efficiently mobilise and channel scarce financial resources through to the "right" enterprises, while avoiding wasteful support for the "wrong" enterprises. Crucially, the above simple typology is mainly derived from the important insights gained from development experiences in Europe and Asia, which show that a strong causative link emerged between regions/localities that have constructed just such an approximation to a "developmental" financial system, and a subsequent sustainable and equitable economic and social development trajectory. It is increasingly accepted in many parts of Europe, notably in Germany, France, Italy, Switzerland and the Scandinavian States, as well as in the USA and post-war Japan, that the local financial system has played an absolutely pivotal role in securing long-term local economic and industrial success. We then find that very similar local institutions were established in many parts of post-colonial Asia just prior to the explosive growth and major poverty reduction episodes that took place in one country after another. Here, in a nutshell, we have the real local alternative to the microcredit model. In unpacking the core aspects of this model a little further, three actual sets of interlocking local institutions appear to be of most importance to a genuinely "developmental" local financial system.

3.2 A developmental local financial system

3.2.1 *Financial co-operatives and co-operative banks*

From the mid-1800s onwards a large number of financial cooperatives and cooperative banks were established in Europe, and these institutions soon came to be associated with sustainable and equitable local economic development. Important examples include the co-operative banks of northern Italy, which have a long and distinguished history of supporting local economic development.[78] However, their real strength was shown in 1945 when, once restructured and re-capitalised, they went on to play a quite decisive role in rebuilding the region's SME based industrial sector into perhaps the world's leading example.[79] In particular, important lessons can be learned from the individual region of Emilia Romagna. This was a once poor region that began to flourish in the post-war era largely thanks to patient co-operative bank support for a manufacturing led SME development trajectory. The co-operative banks usefully built upon both the region's largely destroyed military-industrial complex,[80] and its long experience with co-operative enterprises, in the process creating the world's leading regional cluster of worker and other cooperatives.[81] Note in passing that although many of the traditional Milan and Turin based big private banks recovered after the war, they were mainly (self-)interested in financing the lucrative consumer goods import trade on

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[78] For the best description of this phenomenon, see Zamagni S & Zamagni V *Cooperative enterprise: Facing the challenge of globalization* (Cheltenham: Edward Elgar 2010).

[79] Goglio S & Alexopoulos Y (eds) *Financial cooperatives and local development* (London: Routledge 2012).

[80] Capecchi V "A history of flexible specialisation and industrial districts in Emilia-Romagna" in Pyke F, Becattini G & Sengenberger W (eds) *Industrial districts and interfirm co-operation in Italy* (Geneva: ILO 1990) at 27.

[81] On this, see Bateman (2007) at 39-42.

behalf of still relatively wealthy Italians, not in promoting long-term local economic development outcomes through careful support for the SME sector.

Germany effectively stands as the "home" of co-operative banking, thanks to Hermann Schulze-Delitzsch and Friedrich Wilhelm Raiffeisen, both of whom pioneered differing versions of credit co-operatives that eventually became a bulwark in helping establish and sustain Germany's small enterprises, especially the famous "Mittelstand" (medium-sized enterprises).[82] Also efficiently serving the SME sector at the local level in post-war West Germany were the co-operatively owned savings banks ("sparkasse"), which, likewise, proved to be very successful - *too* successful in fact[83] - in promoting a bottom-up industrial development trajectory based on small quality-based, technologically savvy and innovative enterprises.[84]

Spain provides two important examples of highly successful co-operative based local financial systems: one famous, and the other much less so. The first is located in the Basque region of northern Spain. The Caja Laboral Popular (CLP) attached to the famous Mondragon Co-operative Complex has proved over 50 or more years to be a very successful promoter of manufacturing based cooperative.[85] Such is its diligence, as well as the quality of its technical support, worker training and business planning, that the CLP has only ever had to deal with a handful of failed co-operative enterprises in its entire existence. As one long-time observer concludes,[86] the CLP's long-term loans and other financial support measures effectively laid the basis for an entire regional economy based on local manufacturing and innovation.

The other less recognised example from Spain is Cajamar. Located in Almeria Province in the south of Spain, Cajamar, is today the largest cooperative bank in Spain. Its importance is that it served as the core driving force behind a local economic development success story that, very much like in the Basque country, turned Spain's poorest region into one of Spain's (and Europe's) richest and most productive regions.

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[82] Harm C *The financing of small firms in Germany,* Policy Research Working Paper 899 (Washington DC: World Bank 1992).

[83] So successful were the savings banks (and Landesbanken – see below) in providing low-cost capital to Germany's SME sector, eventually in conjunction with a public guarantee that was offered to them because they were so well-managed, community oriented and (so) low risk, that eventually a number of SME business associations in other European countries began to attack the German system as being *too* efficient compared to their own market driven high-cost private banking sectors, thus unfairly advantaging German SMEs. The European Commission agreed. But rather than promoting a similarly efficient German style co-operative banking structure elsewhere in the EU, the neo-liberal-oriented European Commission decided it had better dismantle the German system instead. In 2001, the German government finally gave in to the European Commission's pressure and agreed to phase out the former public guarantees for local savings banks by the year 2005 - see Bülbül D, Schmidt R & Schüwer *Savings banks and cooperative banks in Europe* White Paper Series No. 5, (Centre of Excellence, Goethe University 2013) at 6.

[84] Hakenes H, Hasan I, Molyneux P & Xie R *Small banks and local economic development.* Bank of Finland Research Discussion Paper 5 (2014).

[85] Bateman M, Girard B & McIntyre R *Promising practices: An integrated cooperative approach for sustainable local economic and social development in the Basque region of Spain.* Report on a UNDP Study Visit to Spain. (New York: UNDP 2006).

[86] Ellerman D *The socialisation of entrepreneurship: The Empresarial Division of the Caja Laboral Popular* (Somerville: Industrial Cooperative Association 1982).

The "Almeria Model" that has been carefully distilled from this experience is based on Cajamar's self-appointed active role in local economic and community development (felt necessary since most local government capacity was destroyed by the civil war) and, in particular, its patient support for clusters of agro-industrial SMEs serving an increasingly intensive agricultural sector.[87] In addition, as Cajamar's own capacity developed, it was able to become a constant source of further social innovation, technology acquisition and transfer, and other forms of social and economic development. Giagnocavo, Fernandez-Revuelta Pérez and Uclés Aguilera conclude their summary of Cajamar's contribution as one where "a cooperative bank, in concert with the cooperative movement, was able to construct an economically stable community through sustainable innovation".[88]

3.2.2 *Local state owned and directed financial institutions and development banks*

Many countries in post-war Europe also owe their economic success to a variety of local state co-ordinated financial institutions. These institutions were established with the specific intention that they would underpin newly formulated local industrial policies that were being pushed through by newly elected local and regional governments. In post-war West Germany, this meant the Landesbanken, or regional banks, which were jointly owned by the savings banks ("sparkasse") and served as their central clearing institution, and the respective regional governments ("Lander"). They were particularly important in providing low-cost funds to help the "Mittelstand" (medium sized enterprises) get back on their feet, and also larger enterprises based in their territorial jurisdiction. In Northern Italy, this meant the state owned and locally/regionally managed Special Credit Institutes (SCIs) that, as Weiss carefully documents, very successfully provided large quantities of affordable financial support (ten year loans at low interest rates) for machinery purchase and workshop modernisation.[89]

Outside of Europe, we find that as regards post-war Japan, David Friedman was able to show that the local state was heavily involved in establishing networks of municipal banks and special funds attached to local governments.[90] These local financial institutions were to prove decisive in supporting networks of highly efficient and technologically adept microenterprises and SMEs capable of inclusion in the famously efficient supplier networks built up around Japan's largest industrial companies. And in the USA, the country's most successful regional development bank - the Bank of North Dakota – happens to be a regional state owned bank. Formed in 1919 to free the local population from the clutches of the big private banks in New York and Chicago that were charging high interest rates on farm loans, the Bank of North Dakota has since then been a major supporter of local businesses and family farms. In addition, it not

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[87] See Giagnocavo C, Fernández-Revuelta Pérez L & Uclés Aguilera D "The case for proactive cooperative banks in local development: innovation, growth, and community building in Almería, Spain" in Goglio and Alexopolous (2012) at 93-110.

[88] Giagnocavo, Fernández-Revuelta Pérez & Uclés Aguilera (2012) at 107.

[89] Weiss L *Creating capitalism: The state and small business since 1945* (Blackwell: Oxford 1988).

[90] Friedman D *The misunderstood miracle: Industrial development and political change in Japan* (Ithaca, NY: Cornell University Press 1988) at 55-105.

only prospered without the need for Wall Street-style salaries and bonuses, it survived the global financial crisis without the need for any state bailout, and it also continued in its role as a major *contributor* (through taxes) to the state's budget.[91]

East Asia's rise to dominance from the 1960s onwards is very much attributable to a range of sophisticated financial intermediation policies, especially involving national and local state development banks.[92] In the immediate post-civil war period, the South Korean State first ensured that long-standing farmer owned credit co-operatives were thoroughly "de-landlordised", before establishing numerous inter-linked local state funding bodies and bank type institutions capable of funding the investment needs of the rural agricultural sector. Food self-sufficiency was reached quite quickly. Meanwhile, after initially focussing its attention on growing the family-owned enterprises ("chaebols") into export successes, in the 1970s the South Korean government began to change course and construct a very effective industrial SME development support structure in the country. Among other things, this effort resulted in the Small and Medium Industry Promotion Corporation (SMIPC) in 1979, strengthened the already existing Korean Credit Guarantee Fund for SMEs, founded numerous State funds (grants and soft loans) to support SMEs in specific sectors and to facilitate new entry, introduced regulations to cajole other banks and financial institutions to build up a portfolio of SME clients, and constructed a raft of Research and Development (R&D) and technology transfer/reverse engineering institutions geared up to supporting SMEs.[93] These measures were especially decisive in building quality subcontracting capacity that enabled the "chaebols" to grow rapidly and capture export markets.[94]

Elsewhere, in Taiwan, Thailand, Malaysia and Indonesia, similar local branches of state owned development banks worked with local governments to successfully facilitate rural industrialisation and also, later on, industrial SME development through manufacturing led technology-based SMEs.[95]

China learned much from these successful Asian examples. It is not so well-known that China's initial growth impetus came in the 1980s not from FDI, as is often commonly assumed, but from rafts of local government owned and industry-based Township and Village Enterprises (TVEs). Generously endowed with the latest foreign production technologies, with easy access to the entrepôt port of Hong Kong, yet all the

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[91] See 'How the nation's only State-owned bank became the envy of Wall Street', *Mother Jones*, 27 March 2009). Available at http://www.motherjones.com/mojo/2009/03/how-nation%E2%80%99s-only-State-Owned-bank-became-envy-Wall-Street (Accessed 10 April 2014).

[92] See Amsden (2001); Chang (2006).

[93] Nugent J & Yhee S *Small and medium enterprises in Korea: Achievements, constraints and policy issues* (World Bank: World Bank Institute 2001) at 22.

[94] Hodgkinson A *The internationalisation process of Asian small and medium firms* Working Paper 00-10, Department of Economics, University of Wollongong (2000) at 14-15.

[95] See Wade (1990); Lall (1996); Meyanathan S (ed) *Industrial structures and the development of small and medium enterprise linkages: Examples from East Asia* (Washington, DC: World Bank 1994); Hutchinson F (ed) *Architects of growth? Sub-national governments and industrialisation in Asia* (Singapore: Institute of Southeast Asian Studies 2013).

while subject to hard budget constraints, the TVEs began to proliferate very rapidly right from the start. By the mid-1990s there were nearly 7.6 million industrial TVEs operating right across China,[96] which represents probably the most successful experience of "municipal entrepreneurship" of all time. It is even less well known that the crucial financial backing for the hugely successful TVE sector largely came from rafts of urban and rural credit co-operatives (UCCs and RCCs). These were set up and largely majority controlled by local governments, but with a broad element of community ownership.[97] Importantly, the RCCs and UCCs were incorporated into local development plans, and so could receive additional core funding and other forms of support from local government. Local government ownership also gave local savers the confidence necessary to mobilise sufficient local savings (for example, local people knew their savings could not be transferred out of the locality and possibly wasted on supporting heavy "rustbelt" industries in the north of China).

A little later, Vietnam closely followed China's model and established a similar set of very sophisticated local financial institutions under local government control and oversight. This local institutional mix proved capable of successfully developing the rural agriculture base, before it then turned to very successfully supporting a rural industrialisation and industrial SME development trajectory. [98]

In Latin America from the 1950s onwards, and in spite of some obvious limitations, state bureaucracies nevertheless proved vital in providing financial support to numerous industries and smaller suppliers through its Import Substitution Industrialisation (ISI) policies.[99] Brazil's state development bank, BNEDES, has almost uniquely provided the driving force behind that country's recent economic miracle. It did this by judiciously supporting key large enterprises (such as, famously the aircraft maker Embraer), but also the SME sector, both directly with affordable loans, and indirectly through the very extensive use of local content agreements attached to its large company investments.

3.2.3 *A "locally-embedded" private banking sector*

The third constituent part of a "developmental" local financial system is the private banking sector, but a "locally embedded" one rather than the freewheeling type of private bank of textbook and, later, Wall Street fame. Such "embedded" banks are often family owned, and they willingly operate within a tissue of dense regulations, have long-standing trust based connections with local businesses and other institutions (Chambers of Commerce, entrepreneurs associations, trade unions, etc), and respect traditional societal/community obligations. Unlike the majority of profit maximising

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[96] O'Connor D "Rural industrial development in Vietnam and China: A Study in contrasts" (1998) 8 *MOCT-MOST* 7.

[97] Girardin E & Xie P *Urban credit co-operative in China*, Organisation for Economic Co-operation and Development, (OECD) Development Centre Technical Paper No 125 (Paris: OECD 1997).

[98] Bateman (2010) at 191-198.

[99] Amsden A "Import substitution in high-tech industries: Prebisch lives in Asia!" (2004) 82 *CEPAL Review* 75.

private banks, therefore, these "embedded" banks provided an important impetus and incentive structure to efficiently support effective local economic development, and for reasons other than pure profit maximisation. Once again in northern Italy, smaller private banks operating in communities to which they felt an obligation, were inevitably much more willing to support the reconstruction of the local industrial and agricultural sectors, offering low-cost loans, grace periods and other benefits to ensure that projects supported had the best chance of success. This very positive process of embedded local obligation and horizontal mutual support structures has been summarised by Giacomo Becattini in his "theory of the local bank". [100]It was an insight that proved useful in helping to explain why the local financial system in northern Italy was such a positive factor in local economic development compared to its counterpart in southern Italy, where the local financial system was embedded within vertical private patronage (and often criminal) networks which engendered very little trust, reciprocity and mutual support structures.[101]

Overall, therefore, the three-cornered "developmental" local financial system model described above differs very significantly from the "pure" neoclassical textbook private sector led version, and it also has little do to with the microcredit model that emerged in the 1980s under the auspices of the international development community. The "developmental" local financial system is one characterised by an evolving mixture of co-operative, local state owned/controlled and private but community oriented (rather than [just] profit maximising) financial institutions that develop a way of working together in order to promote key local industrial development goals, above all through the programmed expansion of the formal SME sector. The precise arrangements governing the operation and coordination of these local financial institutions were, of course, dependent upon an individual locality's and country's own history, economic structure, balance of class forces, international relations, and other idiosyncratic factors. But the general recipe here was to mobilise funds and socialise the risk involved in providing long-term affordable financial support to the "right" industrial and agro-industrial SME enterprises - and, it must be emphasised, which the market on its own would not otherwise provide - and to avoid wasting scarce financial resources propping up the "wrong" enterprises.

4 THE FIRST POST-APARTHEID GOVERNMENT OPTS FOR "ANTI-DEVELOPMENTAL" MICROCREDIT

4.1 The end of apartheid

Before 1996, the African National Congress (ANC) spent many years propounding a state co-ordinated economic model with significant elements of financial planning for

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100 Becattini G "The Marshallian Industrial District as a socio-economic notion" in Pyke F, Becattini G & Sengenberger W (eds) *Industrial districts and inter-firm co-operation in Italy* (Geneva: ILO 1990) at 37-51.

101 Putnam R, with Leonardi R & Nanetti R *Making democracy work: Civic traditions in modern Italy* (Princeton NJ: Princeton University Press 1993).

enterprise development. For example, under the rubric of "socialism from below",[102] important aspects of the "developmental" local financial system noted above, such as, support for regional/local State banks and mutual banks/financial co-operatives, were included in the ANC's famous Freedom Charter published in 1955. Some aspects of this approach were also gleaned from the quasi-developmental State that was constructed in pre-war South Africa in order to more firmly embed white rule.[103]

Once apartheid was no more, the new ANC government was left with a very bitter legacy of conflict and oppression, a disoriented population, and a distorted and failing economy; in other words, a huge package of problems that would prove very difficult for *any* new government to do anything about in the short term. Still, given the horrendous living and working conditions within the majority Black community in South Africa, a radical and far-reaching program was clearly desperately needed. Moreover, recent history provided many useful examples of successful state mediated post-conflict recovery episodes that could guide the policymakers in the first democratically elected South African government.[104] However, the incoming ANC government was persuaded instead to drop virtually all aspects of its radical economic policy platform and sign up to mainstream World Bank-International Monetary Fund neo-liberal ideas concerning the central imperative of constructing purely private market-driven financial intermediation processes and institutions.[105] The redesign of the financial system in post-apartheid South Africa, including the *local* financial system, was thus very much undertaken in accordance with key neo-liberal imperatives.[106]

One of the most far-reaching local financial sector developments in post-apartheid South Africa was the arrival of the market driven microcredit model. Even though the African continent has a long history of community-based self-sustainable

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102 Satgar V "The Solidarity economy alternative in South Africa: Prospects and challenges" in Satgar V (ed) *The solidarity economy alternative: Emerging theory and practice* (Pietermaritzburg: University of KwaZulu-Natal Press 2014) at 199-226.

103 Freund B "A ghost from the past: the South African developmental state of the 1940s" (2013) No 81/82 *Transformation: Critical Perspectives on Southern Africa* 86.

104 The recovery of western Europe in the aftermath of World War Two is one obvious example, especially in the UK, where the sacrifices of the many were effectively addressed by bringing about full employment, establishing a national health service, revitalising key industries under state ownership, and introducing comprehensive social provision (state pensions, unemployment support, free education for all, etc), all in just a few years thanks to Keynesian-inspired state-led investment and progressive taxation. West Germany achieved a similar reconstruction success story thanks to a variety of state (national and regional) institutions, including banks, established to pilot the economy into better times. The north of Italy and France were famously able to reconstruct through careful state intervention and a 'consensus-driven' economic policy framework. Elsewhere in the aftermath of war and decolonisation, such as in Japan, Taiwan and South Korea respectively, similar state-coordinated reconstruction and development programs brought about the East Asian "miracle" - see Amsden (2001); Chang (2006); Weiss (1998).

105 Bond P *Talk left, walk right: South Africa's frustrated global reforms* (Johannesburg: University of KwaZulu-Natal Press 2004).

106 McDonald D & Smith L "Privatising Cape Town: From apartheid to neo-liberalism in the Mother City" (2004) 41(8) *Urban Studies* 1461.

finance,[107] the commercial microcredit model was seen as a radically better way of doing things according to the logic of the market and private entrepreneurship. In the run-up to the end of apartheid, a number of international development community funded microcredit programs were established in South Africa, including the Get Ahead Foundation (GAF) and the Small Enterprise Foundation (SEF). The first ANC government was then given strong encouragement to support microcredit programs. South Africa's strong commercial banking also began to provide microcredit directly via their branch networks, and also via wholesale funding to the main MCIs for on-lending to the poor. The supply of microcredit thus began to rise very fast.

Initially, this mere "outreach" factor was cause for huge celebration, and the international development community was praised for its contribution. The ANC government was also lauded for its apparent determination to ensure that Black South Africans now had very easy access to microcredit. However, it soon became clear that the introduction of microcredit in South Africa was having very little impact where it really mattered: on poverty, inequality, social exclusion and "bottom-up" development. First, researchers could find no genuine evidence to confirm any sustained progress in terms of poverty reduction and net job creation in the black communities and rural township areas. Secondly, the massive profits soon being generated by so many MCIs, commercial banks and other private financial intermediaries began to increase inequality, destroy the social fabric and give rise to a modest microcredit bubble that eventually burst in 2002. Thirdly, fantastic rewards were amassed by senior managers and shareholders of MCIs and banks, and these rewards stood in stark contrast to the mass over-indebtedness that gradually began to become a part of everyday life in the Black communities from 1994 onwards. One of the main problems here - recognised early on by many microcredit advocates, but largely ignored out of a fear of tarnishing the basic concept – was the fact that most of the microcredit was supplied to already employed individuals to meet consumption spending needs,[108] not to those with an idea for an income generating project, as per the standard microcredit model.

Recognising that it had better do something to seriously improve and regulate the microcredit sector before it entirely exploded, in 2007 the South African government passed the National Credit Act (NCA). A National Credit Register (NCR) was also set up. Both actions brought a little more transparency, discipline, accountability and fairness into what was an increasingly usurious and out of control microcredit market. Nonetheless, any gains from the NCA were short lived. In fact, as we shall see some even *more* exploitative MCIs began to dominate the market for microcredit. These new participants saw a major profit-making opportunity in providing unsecured microcredit. Many MCIs also took to dropping out of providing lower profit housing mortgages for the poor in order to free up the necessary funds to move into this new hugely profitable market segment. By the end of the 2000s MCIs were supplying

[107] For example, see Shipton P *Credit between cultures: Farmers, financiers, and misunderstanding in Africa* (New Haven: Yale University Press 2010).

[108] Meagher P "Microfinance regulation in South Africa: A comparative perspective" (2002) 57 *Development Bulletin* Institutional Reform and Informal Sector Centre, University of Maryland.

unsecured microloans in massive volumes. A major new cycle of expansion in the overall microcredit market in South Africa had begun. And, once again, this latest expansion was hailed as the solution to South Africa's problems. This time, though, the argument was couched not in terms of the now somewhat outmoded and, as we have seen, wholly inaccurate notion of "promoting poverty reduction and development". Instead, microcredit was increasingly justified in terms of it being able to resolve what was described, though with very little truth to it,[109] as the new and even more pressing problem facing poor communities around the world today – "financial inclusion".[110]

4.2 The current crisis

By 2010, however, thanks to this latest dramatic growth spurt, South Africa's microcredit sector and the majority of its poor clients and their families were plunged into a new, and very much deeper, crisis of over-indebtedness.[111] Nearly half of the 19 million credit active consumers in South Africa were described in 2012 as having "impaired" credit records (meaning they are three or more months in arrears), while a further 15 per cent were described as "debt stressed" (meaning they are one or two months in arrears). This translated into more than 11 million (more than 60 per cent) of all credit active consumers in South Africa being defined as over-indebted.[112] By 2012, South African household debt amounted to a staggering 75 per cent of disposable income.[113] Warning bells began to sound. In mid-2013 there was a palpable fear that the whole structure was about to come crashing down, and the stock market finally reacted. In the first week of May, African Bank lost 17.5 per cent of its stock market value on one day alone, while its main competitor, Capitec, lost 6.8 per cent of its value on that same day.[114] A recovery of sorts was thereafter facilitated, but less through serious structural reform and more through a "band-aid" approach that simply postponed having to deal with the problem until much later. For example, in the case of Capitec this involved introducing risky "extend and pretend" practices familiar to Wall Street at its worst.[115]

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[109] See Bateman M "Let's not kid ourselves that financial inclusion will help the poor" *The Guardian*, 8 May 2012. Available at http://www.theguardian.com/global-development/poverty-matters/2012/may/08/financial-inclusion-poor-microfinance (accessed 6 April 2014).

[110] "Financial inclusion" has been defined by CGAP as" "A state in which all working age adults, including those currently excluded or underserved by the financial system have effective access to the following financial services provided by formal institutions: credit, savings, payments and transfers, and insurance."

[111] James (2014).

[112] See De Waal M "Debt traps, the silent killers of the SA's vulnerable" *Daily Maverick,* 7 August 2012. Available at http://www.dailymaverick.co.za/article/2012-08-07-debt-traps-the-silent-killers-of-the-sas-vulnerable#.U-RqpWNst0k (accessed 20 July 2014).

[113] See "Drowning in debt" *Fin24* 23 March 2012. Available at http://www.fin24.com/Money/Drowing-in-debt-20120323 (accessed 12 April 2014).

[114] See Lefifi T "Bloodletting as unsecured loan bubble pops" *BD Live,* 5 May 2013. Available at http://www.bdlive.co.za/economy/2013/05/05/bloodletting-as-unsecured-loan-bubble-pops (accessed 20 May 2014).

[115] Since 2013, around the time when Capitec's CEO, Riaan Stassen, took early retirement in fact, Capitec has begun to roll its loan book into longer-term loans. This has the effect of postponing when clients formally go into arrears, which maintains saver confidence and 'keeps the show on the road a little longer'. See Graham C, "Capitec's results unpacked: drop the hype, check the numbers – and be afraid" *BizNews.com* 26 September 2013. Available at http://www.biznews.com/thought-

But the widespread fear at the time was that even though short term survival was engineered, even *more* fragility and risk were being built into the financial system. And these fears were finally realised in August 2014, when African Bank collapsed and had to be rescued by the South African government at a cost of nearly USD 1 billion.[116]

How did it come to this? The quite dramatic answer was effectively provided in late 2013 when a large investor in the microfinance sector chose to end its support for highly profitable microcredit investments in South Africa. The core of the problem in South Africa, as the manager of the aforementioned fund candidly conceded was:[117]

> The (microcredit) industry seems to be pumping debt down peoples' throats. It is no longer socially responsible and does not belong in developmental funds[.] The fundamentals are blown and the business model is unsustainable; 70% to 80% of 'new business' is to existing clients. So the trick is to keep them on an indefinite treadmill, always reoffering them a new loan, or reschedule but by lengthening the term to reduce the instalment.

Bombarded with microcredit in such a way that they simply cannot repay even a fraction of what they owe, with official estimates that up to 40 per cent of the South African workforce's income is now spent on repaying debt,[118] South Africa's poor are today caught in a micro-debt trap of quite unimaginable proportions.

5 THE MICROCREDIT MODEL IN SOUTH AFRICA AS AN "ANTI-DEVELOPMENTAL" INTERVENTION

5.1 Most microfinance has gone into consumption spending

While the microcredit model exists on paper to support income generating activities, in South African practice it has emerged since 1994 as very much more about supporting simple consumption spending needs. A large number of MCIs emerged that could deal with the obvious risks of consumption lending activity and make considerable sums of money. This new raft of institutions was made up, first of all, by many long-established private commercial banks "downscaling" into microcredit. Unemployment and poverty in many Black communities then inevitably led to a rise in informal lending bodies, such as local loan sharking operations ("mashonisas"). In addition, Deborah James reported on the surprisingly large number of white government officials who had been eased out

leaders/2013/09/capitecs-results-unpacked-drop-the-hype-check-the-numbers-and-be-afraid/ (accessed 29 May 2014).

[116] See Dolan D "South African central bank to oversee $940 million Abil rescue" *Reuters* 10 August 2014. Available at http://uk.reuters.com/article/2014/08/10/uk-safrica-african-bank-inv-idUKKBN0GA0R320140810 (accessed 12 August 2014).

[117] See "New blow for micro-lenders" *BD Live* 6 October 2013. Available at http://www.bdlive.co.za/business/financial/2013/10/06/new-blow-for-microlenders (accessed 10 April 2014).

[118] See "Garnishees 'exploit all South Africans' - Webber Wentzel" *MoneyWeb* 15 August 2013. http://www.moneyweb.co.za/moneyweb-financial/garnishees-exploit-all-south-africans--webber-went (accessed 15 April 2014).

of their positions after apartheid ended in 1994 and who then also began setting up as micro lenders.[119]

The initial client group for this expanded raft of lending institutions was mainly composed of the upwardly mobile, ambitious and already employed Black middle class. But after 2007, and after the passing of the NCA, the client group changed to include those in the much poorer Black communities already in a degree of informal debt and struggling to cope with grinding poverty. Nonetheless, thanks to such techniques as obtaining a garnishee order on a client's salary, and thanks to high real interest rates (which some MCIs and microcredit advocates go to considerable lengths to hide[120]), it still proved possible to generate substantial returns from such a client base. Such was the attraction of consumption loans that by 2012 as little as six per cent of the total volume of microcredit advanced in that year was actually used for business purposes.[121]

Several major problems were created here, however. First, the profit-driven move into consumption lending directly created the massive over-indebtedness problem currently washing across all of South Africa's poor rural communities and townships.[122] There can surely be no doubt whatsoever that canny profit-driven MCIs have managed to seduce South Africa's Black population into taking out way too much credit. Moreover, just as in many other countries, it is important to note that South Africa possesses an apparently well-developed and well-functioning network of credit bureaus,[123] but these have been able to do nothing whatsoever to preclude the massive over-indebtedness in the population. Secondly, we also know that increased consumption spending is always undertaken at the expense of investment. Consumption spending is therefore generally detrimental to long-term growth and development, as we find in Latin America,[124] and almost everywhere else in practice.[125]

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119 James D "Money-go-round: personal economies of wealth, aspiration and indebtedness" (2012) 82(1) *Africa* 20.

120 For example, the Founder and Managing Director of the Small Enterprise Foundation (SEF), John de Wit, led a boycott of the reputable Microfinance Transparency organisation (co-founded by Chuck Waterfield and Muhammad Yunus), when it came to South Africa to assess the real interest rates being charged by the country's microcredit industry. The fear was that if the public and the South African government became aware of the high level of interest rates actually being charged to South Africa's poor, there might be an even bigger backlash against the sector than that already underway – see Bateman M "The rise and fall of microcredit in post-apartheid South Africa" *Le Monde Diplomatique*, 12 November 2012. Available at http://mondediplo.com/blogs/the-rise-and-fall-of-microcredit-in-post (accessed on 10 April 2014) at footnote 26.

121 See 'South Africa: Microfinance and poverty alleviation in South Africa' *Mondaq* 11th November 2013. Available at http://www.mondaq.com/x/274240/Microfinance+And+Poverty+Alleviation+In+South+Africa (accessed 16 November 2013).

122 Bond P "Debt, uneven development and capitalist crisis in South Africa: from Moody's macroeconomic monitoring to Marikana microfinance mashonisas" (2013) 34(4) *Third World Quarterly* 569; James (2014).

123 Calvin B & Coetzee G (eds) *A review of the South African microfinance sector, 2009: Successes, challengers, and policy issues*. *Volume 1: Summary of findings* (Johannesburg: Centre for Microfinance and Finmark Trust 2010) at 13.

124 See Ffrench-Davis R & Griffith-Jones S (eds) *Coping with capital surges: The return of finance to Latin America* (Boulder Col: Lynne Rienner Publishers 1995).

Thus, with a very large part of South Africa's scarce financial resources being recycled back into unproductive consumption spending, this trend since the end of apartheid has inevitably starved many investment projects of funds (the opportunity cost). The increasing MCI-driven emphasis in South Africa on lending to support consumption spending, therefore, has played a negative role in terms of investment projects foregone (see also the more detailed "opportunity cost" argument presented below).

Interestingly, because it enables us to begin to better understand the motives at work here, we can analyse how the microcredit movement in South Africa has responded to the catastrophic impact of over-lending for consumption spending. Rather than rethinking the microcredit model, or agreeing to its phasing out and replacement by more "developmental" financial institutions (as discussed in Section 3), the leading MCIs and microcredit advocates have instead taken to retrospectively claiming that such consumer microloans are not true microcredit after all. So, the argument runs, there is no need for any fundamental change here. Founder of the Small Enterprise Foundation (SEF), John de Wit, has responded to the claim that those South African MCIs providing mainly consumer loans and making significant profits, such as Capitec, are actually not MCIs at all, but nothing more than exploitative "payday lenders".[126] Others working in the microfinance sector tend to concur, claiming that consumer lending is *by definition* not microcredit.[127]

None of these claims stand up to any sort of scrutiny, however. The best illustration of why this is so is provided by looking at the key MCI example often quoted as the best example of an MCI masquerading as a payday lender - Capitec. For at least two reasons, Capitec simply cannot be redefined as something other than an MCI. First, Capitec provides microloans on terms and conditions not unlike – in many cases much *better* (starting at around 31 per cent interest rates, for example) – than the majority of MCIs across Africa, and in South Africa itself.[128] If Capitec is NOT a genuine MCI in terms of its interest rates, then virtually the entire population of MCIs across Africa - and indeed the world - would have to be similarly disqualified as MCIs. Second, key microfinance advocates in South Africa have long treated Capitec as a genuine MCI.[129] This includes Gerhard Coetzee, probably South Africa's most authoritative and high-

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[125] Beck T, Lin C & Ma Y "*Why do firms evade taxes? The role of information sharing and financial sector outreach"* Annual Bank Conference on Development Economics - Accountability and transparency for Development, 7 – 8 May 2012, Washington DC (2012).

[126] See Bateman (2012).

[127] This, for example, was the view of several of the senior microfinance program officials in Small Enterprise Finance Agency (SEFA) Limited when asked for their response to the enormous over-indebtedness problems caused by consumer loans in South Africa.

[128] See "Capitec's 'ridiculous' interest rates" (2013) *Fin24*, 1 July 2013. Available at http://www.fin24.com/MyFin24/Capitecs-ridiculous-interest-rates-20130701 (accessed 28 April 2014).

[129] This is the position of microcredit consultant, Graham Wright, the CEO of MicroSave and a leading microfinance advocate in Africa and India, who argues that Capitec is actually one of the leading MCIs in South Africa – see Bateman M "Microcredit has been a disaster for the poorest in South Africa" *The Guardian*, 19 November 2013. Available at http://www.theguardian.com/global-development-professionals-network/2013/nov/19/microcredit-south-africa-loans-disaster (accessed on 29 May 2014).

profile supporter of the microcredit model.[130] In 2003 Coetzee wrote one of the main evaluations of Capitec, a report that pointedly praised it for its contribution to development and financial inclusion in South Africa, *and which never once questioned the status of Capitec as a genuine MCI*. We should note also that the conventional wisdom in the global microfinance industry is that consumption loans are a completely valid, if not very important, aspect of the microfinance model.[131]

The dramatic recent shift of South Africa's financial resources into microloans for consumption purposes is today being much more widely viewed as an important step backwards. As one of South Africa' leading financial analysts put it publicly, this is because "[c]redit made available to households in South Africa is anything but developmental".[132]

5.2 Little short-term impact on employment and incomes

The second fundamental problem with the microcredit model in South Africa follows on from the awkward fact that the small percentage of the total volume of microcredit that actually *does* go into supporting investment in South Africa, in the form of microcredit to support an income generating activity, does not have the employment and income generating impact that it is claimed to have: in fact, microcredit has an almost zero short-term impact on employment and poverty, suggesting that it is a largely wasted exercise in this respect. How is this possible?

First, as elsewhere across Africa,[133] and as is always the case in recession hit developed countries as well,[134] jobs created thanks to the high microenterprise *entry* rates in South Africa were in practice almost entirely cancelled out after a short while by equally high rates of *exit* and *job displacement*.[135] The end result was nothing more than a familiar local "job churn" (or "turbulence") effect.[136]

Secondly, thanks to lots of new informal microenterprise entrants, there has also been a negative impact of microcredit in terms of helping to reduce average financial

[130] Coutzee founded and was for many years the Head of the Centre for Microfinance, which in 2011 was renamed the Centre for Inclusive Banking in Africa. In 2013 Coetzee moved to a senior position at the World Bank's microcredit promotional unit - CGAP – based in Washington DC.

[131] Collins D, Morduch J, Rutherford S & Ruthven O *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (Princeton NJ: Princeton University Press 2009).

[132] See Melzer I "Banks exploit financial illiteracy of clients" *BD Live*, 3 December 2013. Available at http://www.bdlive.co.za/opinion/2013/12/03/banks-exploit-financial-illiteracy-of-clients (accessed 20 July 2014).

[133] Page J & Söderbom M *Is small beautiful? Small enterprise, aid and employment in Africa* (2012) United Nations University-WIDER Working Paper No. 2012/94.

[134] Storey (1993); Bateman M "Creating jobs in recession-hit communities in Europe: Why microcredit will not help" *Social Europe Journal* 15 May 2012. Available at http://www.social-europe.eu/2012/05/creating-jobs-in-recession-hit-communities-in-europe-why-microcredit-will-not-help/ (accessed 23 March 2014).

[135] Bateman (2010) at 71; Kerr A, Wittenberg M & Arrow J, *Job creation and destruction in South Africa* A Southern African Labour and Development Research Unit Working Paper Number 92 (Cape Town: SALDRU, University of Cape Town 2013).

[136] See the excellent discussion in Nightingale and Coad (2014).

returns per microenterprise. Increased market competition in South Africa after apartheid fell led to a general softening of the prices of most simple goods and services produced by informal microenterprises. More importantly, there was a reduction in the average turnover per unit as the finite level of demand (at least in the short term) was essentially divided up between a now much larger number of market participants, a good many of whom had been able to tap into microcredit. It is largely as a result of this specific competition, and related job and income displacement factors, that between 1997 and 2003 self-employment incomes in South Africa fell by an astounding 11 per cent per annum in real terms.[137]

In addition, given the already tense inter-ethnic and community relations in South Africa, many researchers have reported on the social tensions that have been greatly exacerbated thanks to the hyper-competition that now prevails in the poorest communities, and which is at least partly traceable back to the unnecessary stimulus to local competition provided by microcredit. Cohen, for example, reported on the anger and resentment caused by larger and larger numbers of "poverty-push" petty retailers aggressively competing with each other for a stable or, especially after 2008, a declining level of business, with very few of them able to make any real inroads in terms of increasing income or increasing their number of employees.[138]

Moreover, this situation has not been helped by the arrival of an estimated 1.5 to 3.5 million illegal migrants from neighbouring countries, notably Zimbabwe, Malawi and Mozambique. As growing numbers of poor undocumented immigrants attempt to find paid employment in South Africa's informal economy, ethnically motivated business "turf wars" are one of the inevitable results of the ultra-competitive local environment created thereby.[139] Clearly misunderstanding the situation, some international development community microcredit programs working with migrants added to the problem by providing special microcredit programs for refugees. With few skills, little experience and no capital (other than the microcredit) most of the refugees quite predictably tried to survive by entering saturated local markets and taking market share from already desperately struggling incumbent operations. Just as predictably, this survival strategy created tension, anger and, ultimately, violence, notably involving the ubiquitous "barrow-boys".[140]

Microcredit advocates quite routinely misunderstand the importance of local market demand and so all too often come to the fundamentally wrong assumption that markets are infinitely elastic. This means, however, that MCIs attempts to incorporate the unemployed into the local market, using microcredit to smooth the way forward for

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[137] Kingdon G & Night J *Unemployment in South Africa, 1995-2003: Causes, problems and policies* Global Poverty Research Group Working Paper GPRG-WPS-010, (Centre for the study of African Economies, Oxford University 2005).

[138] Cohen J "How the global economic crisis reaches marginalised workers: the case of street traders in Johannesburg, South Africa" (2012) 18(2) *Gender & Development* 277.

[139] See "Analysis: The ugly truth behind SA's xenophobic violence" *The Daily Maverick*, 28 May 2013. Available at http://www.dailymaverick.co.za/article/2013-05-28-analysis-the-ugly-truth-behind-sas-xenophobic-violence/#.UnAFdyVwa1s (accessed 24 May 2014).

[140] Bateman (2010) at 71.

new entrants, actually *exacerbate* the problem they say they are trying to solve. Interestingly, we can trace the "oversupply/finite demand" problem we encounter here back to Muhammad Yunus and his famous claim that,[141] "[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."

Many have since debunked Yunus's core belief in the idea that "supply creates its own demand" (known as "Say's Law"). One of these was the late Alice Amsden who pointed out that operating under just such an erroneous assumption has actually undermined and destroyed almost *all* supply-side anti-poverty programs established over the last 30 or so years.[142] One might also view Yunus's fundamental logical error here as akin to the error made by those who long argued that famines were caused by "a lack of food" and that "more food availability" would quickly remedy the problem, when in fact, as Amartya Sen famously showed, the fundamental problem was actually the limited purchasing power of the poor that prevented them from buying the food that was often quite widely available in a famine region.[143]

In short, and entirely predictably based on past experience, the microcredit induced increase in the local supply of simple products and services through informal microenterprises and self-employment ventures did not, and does not, create the local demand to absorb this increased supply. Most communities in South Africa today are already pretty much oversupplied with the simple products and services that potential new microcredit assisted individuals might wish to provide, and this was probably the case at the time the apartheid system collapsed in the early 1990s. Under such conditions, microcredit stimulated new entry has predictably had little impact on the immediate issue of job creation and it has not raised the average income of the poor as much as lowered average income in the informal microenterprise sector. It also brought forth a wave of additional problems associated with saturated local markets and aggressive "dog eat dog" competition, notably those associated with an inevitable resort to client stealing, aggression and violence.[144]

5.3 The destructive rise of Wall Street-style greed and inequality

A third fundamental problem with the microcredit model in South Africa is that it has helped to precipitate the country's very own ongoing Wall Street-style financial chaos, with the result that South Africa is experiencing major knock-on solidarity destroying trends in already alienated communities. Far too many high-profile microcredit supporters and policymakers in South Africa, as very much elsewhere,[145] bought into

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141 Yunus M "Grameen Bank: Organisation and operation" in Levitsky J ed *Microenterprises in developing countries* (London: Intermediate Technology Publications 1989) 144 at 156.

142 Amsden A "Say's Law, poverty persistence, and employment neglect" (2010) 1(1) *Journal of Human Development and Capabilities* 57; see also Galbraith J *The predator state: How Conservatives abandoned the free market and why Liberals should too* (New York: Free Press 2008) at 151-163.

143 Sen A "Ingredients of famine analysis: Availability and entitlements" (1981) 96(3) *The Quarterly Journal of Economics* 433.

144 On this phenomenon globally, see Davis M *Planet of slums* (London: Verso 2006).

145 Probably the most enthusiastic on this issue have been Otero & Rhyne (1994); and Robinson (2001).

the textbook myth of the perfectly functioning free market and all of the standard "efficient market" assumptions that followed therefrom. The central mistaken belief therefore emerged that commercialised MCIs would dutifully stick to their declared corporate mission statement and *responsibly* lend to the country's poor. Indeed, on the assumption that all MCIs were singularly dedicated to helping the poor, all that was really required, according to the most naïve,[146] was simply to monitor an MCI's "social performance" in order to offer friendly advice to it on how to improve matters in future, advice that would be readily taken up and implemented without question.

Just possibly more than anywhere else in the world, however, in South Africa this assumption proved to be quite spectacularly wrong. In fact, as noted above, it is now abundantly clear, and accepted even within the financial sector itself,[147] that the *real* aim of the private banks and MCIs in South Africa today is not (or is no longer) to help their poor clients, *but to extract as much value from them in the shortest time possible and no matter what the eventual consequences for them might be*.

For the best illustration of this debilitating trend we can turn once again to Capitec Bank. Fast-growing Capitec Bank has been singled out by many analysts as *the* pioneer MCI in South Africa in terms of excessive profiteering and exploitation of the very poorest. Indeed, many now accept that Capitec is nothing less than the country's very own version of Banco Compartamos. Just as with Banco Compartamos, Capitec stands out among other MCIs in South Africa for two developments that are not quite in keeping with a supposedly pro-poor institution. First, there are the spectacular profits and dividends reaped by shareholders since its establishment in 2001. Secondly, there are the equally spectacular salary and bonus payments self-awarded to its senior managers, especially to its high-profile White South African CEO, Riaan Stassen, rewards that have turned him into one of South Africa's richest net worth individuals.[148] Awkwardly, this private enrichment process actually took place under the noses of a number of senior ANC figures, who had quietly invested in Capitec through an otherwise anonymous financial investment vehicle.[149] To cap it all, there is a steadily growing fear that the rapid growth business model that actually underpinned Capitec's

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[146] See Simanowitz A "Achieving poverty outreach, impact and sustainability: Managing trade-offs in microfinance" in Balkenhol B (ed) *Microfinance and public policy: Outreach, performance and efficiency* (Basingstoke: Palgrave Macmillan for the ILO 2007) 60.

[147] See "New blow for micro-lenders" *BD Live* 6 October 2013. Available at http://www.bdlive.co.za/business/financial/2013/10/06/new-blow-for-microlenders (accessed 4 November 2013).

[148] Awarded in 2004 a personal shareholding of 167,645 shares priced then at R7.61 per share (i.e., a total value of around R1.3 million), in mid-2012 Stassen off-loaded a fifth of his shares for nearly R100 million (around USD 11.5 million) at a price per share of around R220, with nearly R400 million (around USD46 million) of *Capitec* shares still held by his private investment company. See "80m share bonus for Capitec boss" *Fin24*, 6 May 2013. Available at http://www.fin24.com/Companies/Financial-Services/R80m-share-bonus-for-Capitec-boss-20130506 (accessed 2 April 2014).

[149] See "Capitec unaware share sale may have funded the ANC" *Moneyweb*, 28 September 2012. Available at http://www.moneyweb.co.za/moneyweb-financial/capitec-unaware-share-sale-may-have-funded-the-anc (accessed 29 May 2014).

fabulous financial rewards to date, is now finally coming apart at the seams,[150] (though CEO Riaan Stassen has rather conveniently departed into early retirement[151]).

The increasingly Wall Street-ized microcredit industry in South Africa has created a number of problems that have combined to undermine the development of the local economy and trust and solidarity in local society. South Africa's position as one of the most unequal countries in the world has been further solidified by the quite predictable operations of its market driven microcredit sector, which places far more value on rewarding (often quite spectacularly) the suppliers of microcredit than it does on improving the position of the recipients of microcredit languishing in poverty. The general emulation of Wall Street trends has contributed to the further corrosion of all remaining forms of inter-class, inter-ethnic and inter-community solidarity, trust, mutual support and reciprocity in South Africa, thus *exacerbating* the already wide social cleavages that existed in apartheid South Africa. The majority of South Africa's MCIs can best be described today as "cathedrals in the desert" – hugely profitable and prestigious institutions standing tall in the financial community, but increasingly surrounded by a vast and growing desert of poverty, deprivation, inequality, anger and resentment that they have themselves very much helped to create.

5.4 Negative impacts of microcredit in the agricultural sector

As in many other countries,[152] the rise of the microcredit model has had a particularly damaging impact on the critically important agricultural sector in South Africa, a sector that was slated after 1994 to rapidly develop in the wake of land reform and restitution and with the State turning its attention towards promoting sustainable agriculture run by the Black community. Instead, the agricultural sector has languished as a result of the disengagement of the State from any active role in securing an efficient agricultural sector and, importantly, as a result of the turn to microcredit as the dominant (if not *only*) financial package made widely available in the new post-apartheid agricultural system.

Under the apartheid system, as Philip has reported,[153] a "deagrarianisation" dynamic arose in South Africa that effectively robbed poor South African communities of one of the first and most basic foundations for the sustainable growth of local micro- and small enterprises operating in the local economy – local food production. With limited local food production, there is little scope for the growth of local processing, packaging, distribution, retailing, and other related and more diversified local small enterprise activities. As has long been recognised, achieving local food self-sufficiency

[150] See Rees M "Capitec bosses ditch R175m in shares as sector cracks" *BDLive*, 18 May 2014. Available at http://www.bdlive.co.za/businesstimes/2014/05/18/capitec-bosses-ditch-r175m-in-shares-as-sector-cracks (accessed on 29 May 2014).

[151] See "Capitec earnings up as CEO retires" *Fin24*, 25 September 2013. Available at http://www.fin24.com/Companies/Financial-Services/Capitec-earnings-up-as-CEO-retires-20130925 (accessed 29 May 2014).

[152] For example, see Bateman (2010) at 80-91.

[153] Philip K "Inequality and economic marginalisation: How the structure of the economy impacts on opportunities on the margins" (2010) 14 *Law, Democracy and Development* 105.

and growing local financial surpluses constitute an important foundation for subsequent local industrial development through the development of important backward and forward linkages.[154] In East Asia, for instance,[155] achieving food self-sufficiency and an efficient domestic agricultural supply chain, were key preconditions for those countries that went on to create the East Asian "miracle".

However, with little access to good quality land, increasingly small plots of land due to inheritance laws and traditions, land degradation through over-use and little replenishment through organic fertilizer, and crucial supporting infrastructure purposely not made available to them, Black rural communities in South Africa largely failed to develop a local food producing rural economic structure. Thus, one of the principle forms of bottom-up impetus for the sustainable growth of a local micro- and small enterprise population – local food production – was almost completely missing in the Black areas of apartheid South Africa.[156] Thanks to the large numbers of local petty traders, food was largely secured instead from *outside* the local community, mainly from productively efficient White owned farms and cooperatives that made extensive use of cheap Black migrant labour. Among other things, this further exacerbated the structural oppression that was apartheid. Accordingly, for a number of reasons in addition to the job creating potential, in the post-apartheid era the development of the local food economy would appear to be a major priority for the South African government.

Two important microcredit related barriers have in the post-apartheid era worked to prevent any programmed breaking away from this primitive "no growth" local economic/agricultural structure. First, because of its "too inflexible and too expensive" terms we know that microcredit is quite unsuitable for agricultural development.[157] In fact, in order to establish an efficient agricultural sector in general, economic history shows quite convincingly that a source of subsidised long-term capital is actually needed for both individual farms and important institutions.[158] Improvements to the local food production system in South Africa were not possible in the post-apartheid era because the only financial offer made available to a new generation of Black farmers was microcredit, and microcredit was of no real use to the vast majority of small farms now newly owned and managed by Black individuals and

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[154] Vorley B, Fearne A & Ray D (eds) *Regoverning markets: A place for small-scale producers in modern agrifood chains?* (Aldershot: Gower 2007).

[155] See Wade (1990); see also Putzel J *Land reforms in Asia: Lessons from the past for the 21st Century* DESTIN Working Paper Series, No 00-04 (London: London School of Economics 2000).

[156] White farming, on the other hand, was comparatively successful under apartheid, thanks to larger land parcels, large volumes of State subsidised credit, quality State provided extension services, comprehensive irrigation schemes, price supports, extensive State support for farmer owned co-operatives taking produce to final markets, and so on. See Jara M & Satgar V *International cooperative experiences and lessons for the Eastern Cape Cooperative Development Strategy: A literature review*. Eastern Cape Socio-Economic Consultative Council (June-July) Working Paper No 2. (Johannesburg: COPAC 2009) at 5.

[157] Harper M "Microfinance and farmers: Do they fit?" in Dichter & Harper (2007) at 93.

[158] See the penetrating survey of history by Chang under contract to the UN's Food and Agriculture Organisation (FAO) – Chang H-J "Rethinking public policy in agriculture – Lessons from history, distant and recent" (2009) 36(3) *Journal of Peasant Studies* 477.

families.[159] When the need is for much larger loans, at lower interest rates, with much longer maturities, and with grace periods too (to reflect the agricultural cycle), the offer of an unlimited quantity of short-term, high interest rate microcredit is little more than a cruel distraction. Moreover, important collective structures that might have made a decisive difference to the "collective efficiency" of this new generation of Black farmers in South Africa - agricultural co-operatives - as they very much did in the 1950s to an earlier generation of White farmers in the country,[160] can find even *less* use for microcredit.

Secondly, because of the easy availability of microcredit and the low entry barriers pertaining to the trading sector, after apartheid ended very many in the rural community began to establish their own food trading informal microenterprises.[161] However, in the ultra-competitive conditions thereby created, operating and profit margins were driven down to near zero. Little real accumulation was therefore possible. Accordingly, very few petty traders in South Africa have been able to sustainably grow their operations, or else self-finance an important move forward or backward in the supply chain in order to develop more sophisticated and/or more productive activities that could raise the overall efficiency of the supply chain. The local farming community operating under such conditions cannot other than stagnate. Easy access to microcredit in South Africa actually militated *against* the establishment of crucial growth/diversification processes in most of the agriculture based communities.

5.5 Negative long-term impact on "bottom-up" industrial development potential

A final important problem with microcredit in South Africa is its long-tern negative impact on the structure, conduct and performance of the South African industrial and manufacturing base. Initially, very many analysts considered microcredit to be one of the main solutions to South Africa's post-apartheid economic problems. This argument was made on the grounds that microcredit would gradually help to build up an efficient enterprise sector composed of a healthy share of reasonably efficient microenterprises and industry- and service based SMEs, which would in turn contribute to the promotion of growth and development through sales, subcontracting and other links with the largest industrial and manufacturing enterprises. Post-war West Germany and northern Italy were sometimes used by microcredit advocates as the role models South African policymakers need to emulate (see above). In South Africa itself, it has long been recognised that formal manufacturing led SMEs are the key to sustainable local job

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[159] Bateman M *Cooperative development scoping study mission to Mpumalanga Province*. Consultant's report to Mpumalanga Rural Development Programme (July 2010).

[160] Amin N & Bernstein H *The role of agricultural cooperatives in agriculture and rural development* Report to Land and Agriculture Policy Centre: Policy Paper 32 (1995); Jara & Satgar (2009).

[161] See 'Retail dominates South Africa's informal business sector' *Going*, 16 September 2013. http://www.going.co.za/retail-dominates-south-africa-s-informal-business-sector (accessed 29 May 2014).

generation.[162] It greatly helped that South Africa had a major advantage over other African economies in that it was already a comparatively highly industrialised country in 1994 as apartheid came to an end. Policymakers certainly did not want to see a reversal of this situation, but South Africa's then industrial structure used instead as the foundation for a renewed emphasis on industrial development, building manufacturing capacities and so also generating plenty of high-skilled and well-paid jobs.

However, as the labour market data attest to, and most surveys undertaken in South Africa repeatedly point out as well, one of the principal barriers holding back the growth and expansion of formal SMEs is that they have had major difficulty gaining access to credit on appropriate terms and maturities,[163] especially if the applicants originate in the Black community. Moreover, the growth that *has* taken place in the formal SME sector appears to have been in the quick-turnover services sector, which is a sector defined by low capital intensity, but then also much less impactful on growth and development compared to industry and manufacturing.[164] The International Finance Corporation's (IFC) Enterprise Survey for South Africa also found that for formal manufacturing led businesses "access to finance" was the third most important and long-running business environment constraint, topped only by "crime, theft and disorder" in first place and "electricity" in second place.[165] This capital shortage, of course, has arisen in spite of the explosion in the supply of (micro)credit that took place after 1994. Nicely summing up the paradox here is the current Minister of Trade and Industry, Rob Davies, who sees the crux of the long-term development problem in the fact that[166] "[t]he (South African) economy is characterised by extensive financialisation, *but only a small percentage of investment is channelled towards the productive sectors*."

Meanwhile, as shown above, South Africa's vast microcredit sector is responsible for having channelled the country's financial resources into consumer lending, but also into the very lowest productivity and least transformational enterprises of all – informal microenterprises and self-employment ventures. Against most predictions made as the

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[162] For example, see the analysis in Pollin R, Epstein G, Heintz J & Ndikumana L *An employment-targeted economic program for South Africa* (Cheltenham: Edward Elgar 2007).

[163] Turner M, Varghese R & Walker P *Information sharing and SMME financing in South Africa: A survey of the landscape* (North Carolina: PERC Press 2008) at 15.

[164] A further problem revealing itself of late is that much of the actual registered growth in SME numbers in services is mainly composed of certain activities in large enterprises that have been outsourced to 'new' SMEs deliberately set up to receive a contract, thereby to undertake this contract work much cheaper by avoiding tax, being non-unionised, employing ultra-low cost informal labour, providing no social benefits, and so on. For example, Tregenna points out that as much as a fifth of the total growth of private services employment between 2001 and 2007 in South Africa was related to the simple outsourcing of cleaners and security guards alone. – Tregenna F "How significant is intersectoral outsourcing of employment in South Africa?" (2010) 19(5) *Industrial and Corporate Change* 1452.

[165] IFC Enterprise Survey South Africa "Obstacles for firms" 2007. Available at http://www.enterprisesurveys.org/Data/ExploreEconomies/2007/south-africa#finance (accessed 5 February 2014).

[166] Speaking notes of the Minister of Trade and Industry, Dr Rob Davies, at the launch of the Industrial Policy Action Plan (IPAP) 2013/14-15/16 held at the IDC, Sandton, Johannesburg on 4 April 2013. Emphasis added.

apartheid economy was consigned to history in 1994, especially in the neo-liberal oriented Growth, Employment and Reconstruction Strategy (GEAR), the lowly paid, insecure, no growth informal sector expanded to become the core employment opportunity for the poorest Black communities.[167] By 2007 the most important part of the informal sector in South Africa was in the petty retail and vendor sector (including so-called "barrow boys"), with nearly 500000 individuals engaged in such activities.[168] Moreover, new informal microenterprises are still the main form of entry activity in South Africa today, as indicated above, while it is also the case that small enterprises (10-49 employees) continue to rapidly contract and fall into the category of microenterprise (1-0 employees).[169] As one recent report noted,

> Since January 2013, the informal sector has added 73, 799 jobs, compared to a total decline of 241,536 permanent and temporary jobs (in SMEs and large firms), reflecting the growing importance of the informal sector in the South Africa labour market.[170]

Summarising the situation, another report could only conclude that, "South Africa's formal labour market is gradually disintegrating." [171] There is also another important "crowding out" effect that we need to briefly mention here, one that is related to the rise of informal industrial microenterprises compared to formal and larger enterprises operating in the same sector. As Vargas has noted in relation to microcredit saturated Bolivia,[172] but it's a global problem,[173] the programmed microcredit induced expansion of the informal industrial microenterprise sector all too often serves to undermine the sustainable development of the formal industrial SME sector through its "unfair competition" direction. This is when the enlarged informal microenterprise sector takes valuable demand (albeit often just temporarily) *away* from more productive SMEs that would have otherwise allowed those SMEs to operate on a more efficient (larger) scale of operations, deploy the best technology, train their workers, reinvest in new products and processes, and so on. That is, the informal industrial microenterprise sector very typically "crowds out" the formal SME sector not because it is more productive or competitive than formal sector SMEs in the positive Schumpeterian "high road" sense, but simply because it is able to undercut the formal SME sector by paying subsistence wages, routinely avoiding any tax responsibilities, demonstrating no concern to invest in safe working conditions, and so on (the "low road" option). The World Bank's IFC arm identifies this problem in almost all of its annual Enterprise Survey reports, for example,

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167 Wills G *South Africa's informal economy: A statistical profile* Urban Policies Research Report No 7, (WIEGO Urban Policies Research Report Series 2009).

168 Wills (2009) at 48.

169 SBP "Developing a new path for SMEs in South Africa; Reassessing for growth" (2013) Issue 12 *ALERT* at 6.

170 See "Jobs 2013: Informal sector shows SA who's boss" *Mail and Guardian* 13 January 2014. Available at http://mg.co.za/article/2014-01-13-nearly-24-000-new-jobs-reveal-informal-sectors-worth (accessed 29 May 2014).

171 Adcorp Employment Index September (2011) at 2. Available at http://www.adcorp.co.za/news/pages/informalemploymentinsarises,formalemploymentfalls.aspx (accessed 29 May 2014).

172 Vargas J *Binding constraints: Does firm size matter?* ARU Foundation, 4 September 2012.

173 Farrell D "The hidden dangers of the informal economy" (2004) 3 *McKinsey Quarterly* 26-37.

when managers of formal industrial enterprises consistently report that informal sector competition is one of the main barriers preventing them from developing and expanding their businesses.[174]

It is therefore clear that South Africa's long-term growth and development chances have been progressively undermined, to a greater or lesser extent, thanks to its increasingly microcredit-dominated local financial system. What has arisen is a local financial system that programmatically channels the country's scarce financial resources *towards* the most unproductive informal industrial microenterprise and self-employment ventures, and so *away* from the most productive and sustainable activities that generally pertain to formal production and industrial services based SMEs. What we are seeing here, then, is the emergence of an important and negative financial sector "crowding out" effect: potential lending to the higher productivity and longer term growth oriented formal SME sector is being "crowded out" by the attraction of the higher profitability to be found in lending activities involving informal microenterprises and self-employment ventures (and, of course, consumer lending too). The unsurprising upshot of all this then, thanks to the significant and partly microcredit induced growth in the number of informal sector participants in South Africa, on the one hand, but almost no real growth in the capital starved formal SME sector,[175] on the other, is that the South African economy is today suffering from its own "missing middle" problem.

6 THE MOST VULNERABLE IN SOUTH AFRICA'S MINING REGIONS TARGETTED WITH MICROCREDIT

As if the negative impacts arising from South Africa's exposure to the microcredit model were not bad enough already, in 2012 an even more deeply damaging development came to light. It emerged that some of the highest profile MCIs in South Africa were maximising profits by deliberately targeting some of the most vulnerable and exploited individuals imaginable - migrant workers working in the crucial mining sector in South Africa. Long one of the most profitable business sectors in South Africa and in the world, it is an uncomfortable fact for many in South Africa that, at the same time, those workers engaged in South Africa's mining sector have to endure some of the most exploitative, lowest paid, insecure, physically demanding and dangerous working conditions anywhere in the world.

The city of Rustenburg is the focal point for much of South Africa's hugely important mining industry. The multinational corporations that own the mines around Rustenburg generate huge profits from the mining of gold, platinum and other rare minerals. However, the individual miners, as well the local community of Rustenburg, do not benefit very much from the extraction of such resource wealth. Rustenburg is part of the Bojanala District Municipality, which has an unemployment rate of around 40 per cent, yet the bulk of the miners are actually migrant labourers brought in from the rural areas outside of Rustenburg by labour brokers hired by the mine owners. The

174 Examples from Latin America are discussed in Bateman (2013) at 15-21.

175 SBP (2013) at 6.

reason for this preference is readily apparent: migrant labourers coming from these very poor areas are even cheaper and more tolerant of abuse and poor working conditions than mineworkers that might be recruited locally. But away from home and their families, with a generally low disposable income thanks to the necessity to support two households (the family household in the rural areas and their lodgings at the mine), working under very harsh and dangerous conditions, and also all too often financially illiterate, many of the migrant mineworkers are especially vulnerable. As such they have sometimes been described in the financial community, rather unfortunately in the light of recent events at the Marikana mine (see below), as "perfect targets".[176]

It was the presence of so many "perfect target" clients in Rustenburg that drew formal financial institutions to this city like bees to honey. In the city of Rustenburg alone, in addition to numerous pay-day lenders and traditional loan sharks ("mashonisas"), a total of 81 formal MCI branches operate to provide financial services to a population of around 250,000 people. Among this number we find African Bank, Capitec, the big four South African banks, Blue Financial Services, Bayport, Real People, Finbond and Old Mutual. These are all reputable financial institutions, we need to emphasise, with almost all of them registered on the Johannesburg Stock Exchange. As of early 2012, the MCI with the largest presence in Rustenberg is African Bank with 19 outlets in the town, followed by JD Group with 16, Capitec with ten, Nedbank with nine, StanBank with seven, and ABSA with five.[177] If we take the population of Rustenburg as 250,000, we find that we have one formal microcredit provider operating in Rustenburg for every 3,000 individuals. This is a simply staggering number of formal microcredit outlets in such a small area, way beyond even the most liberal interpretation of the supposed need to achieve "financial inclusion".[178]

Moreover, a good number of these MCI outlets are deliberately based on the mining premises in Marikana. Importantly, Marikana is the location where on 16 August 2012, a massacre of 34 mineworkers was carried out by police brought into the Lonmin Corporation's Marikana platinum facility to break a strike. This incident represents the worst violence in post-apartheid South Africa to date and, crucially, it took place against a background of massive indebtedness among the Marikana mineworkers. In fact, as very many media reports made perfectly clear, it was precisely the massive level of

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[176] This term was apparently widely used in the financial sector prior to the "Marikana massacre" when referring to potential microloan recipients, but, for obvious reasons, less so afterwards – information obtained from a confidential email commentary on the situation the author received from a senior financial analyst employed at one of the largest commercial banks in South Africa.

[177] Citi Research *Unsecured lenders - Rustenburg: A case study for unsecured lending* 19 September 2012).

[178] Although not fully comparable, the data provided by Berger helps to put the stunning level of MCI penetration in Rustenburg into context. She reports that in Latin America the number of individual clients serviced by the average MCI is around 31,000, which she compares to Asia where an individual MCI on average has up to 130,000 clients. Berger argues that the higher the number of clients serviced, the more efficient the MCI is assumed to be (thanks to economies of scale). In the South African example, of course, scale diseconomies would appear to be minimal, yet they are more than compensated for by high interest rates, one-off fees, penalties, low risk due to garnishee orders, and other specific factors that can be made to generate profit for the average MCI. See Berger M "The Latin American model of microfinance" in Berger M, Goldmark L & Miller-Sanabria (eds) *An inside view of Latin American microfinance* (Washington DC: IDB 2006).

over-indebtedness of the Marikana miners that helped precipitate the confrontation that led to so many deaths.[179] The problems included the fact that a good proportion of the mineworkers were illiterate, and certainly most were *financially* illiterate. Even though the salaries for rock drillers (the most dangerous occupation in the mine) were above local levels for many other occupations in Rustenburg, this turned out to be scant compensation for the horrendous working conditions, the job insecurity, the alienation from family, and the sheer scale of the inequality involved in the mining sector in general.

Given such appalling conditions, it was almost inevitable that the deliberate and massive step-up in micro lending around the Marikana mine would plunge large numbers of mineworkers into un-repayable levels of micro debt. In turn, this led to dangerously high levels of anger, resentment and fear for the future. Unfortunately, the traditional representative of the mineworkers, the National Union of Mineworkers (NUM), an organisation very close to the ruling ANC party in South Africa, was unable or unwilling to negotiate on behalf of the mineworkers. Defections to the local unofficial mineworkers union — the Association of Mineworkers and Construction Union (AMCU) — began to reach record levels, which further added to the poisoned atmosphere: the AMCU was seen as more willing to defend the miners and work to achieve a fair and lasting settlement, whereas the NUM was more concerned about helping out the ANC. Adding insult to injury was the fact that the NUM had also decided to get in on the hugely profitable lending frenzy that got underway in Rustenburg thanks to its part-ownership of UBank, one of the largest and most aggressive MCIs operating in the city.

It is surely not surprising to find that some analysts have argued that the carefully programmed over-indebtedness of so many mine-workers in Rustenburg played an important role in helping generate the appalling conditions that gave rise to the "Marikana Massacre."[180] When stratospherically high levels of over-indebtedness among vulnerable and physically stressed individuals are overlaid upon other pressing economic and social problems, why would one be surprised to find that the resulting pressure can only be contained for so long?

7 CONCLUSION

This article has argued that the microcredit model has played a calamitous role in the hoped for local economic and social development progress of post-apartheid South Africa. In particular, South Africa's scarce financial resources have been increasingly intermediated into consumption spending and, where "invested" at all, into no-growth ultra-low productivity informal microenterprises and self-employment ventures. As in many other locations where such a financial intermediation structure has emerged, the

[179] See Davis R "Marikana: The debt-hole that fuelled the fire" *Daily Maverick,* 12 October 2012. Available at http://dailymaverick.co.za/article/... (accessed 10 April 2014).

[180] Bateman (2012): Bond P "Consolidating the contradictions: from Mandela to Marikana, 2000-2012" in Saul J & Bond P *South Africa: The Present as history; From Mrs Ples to Mandela and Marikana*. (Johannesburg: Jacana Media 2014) at 215.

end result in South Africa has been the deindustrialisation, informalisation, disconnectedness and primitivisation of the average local community, and so a poverty trap has effectively been created thanks to microcredit. In addition, the inequality, greed, aggressive competition, and unfairness that is effectively underpinned by the microcredit model have combined to undermine and destroy the important solidarity bonds both within and across South Africa's local communities. This does not bode at all well, of course, for a country desperately attempting to cast off its vicious apartheid legacy and to move into a new era of social justice and inter-racial accommodation. Like a rapidly growing weed that hogs the sunlight and nutrients required by the slow growing crops around it, the microcredit sector in South Africa has appropriated large quantities of scarce capital, technical expertise, goodwill and government policymakers' attention, all in order to help construct a primitive, unequal and 'no-growth' economic and social structure that is frustrating the legitimate aspirations of previously suppressed communities attempting to survive in the post-apartheid era.