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Introduction: microfinance, rights and global justice

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Financial exclusion is one consequence of extreme poverty. Those with the least in the world are often unable to secure their few possessions or their savings. In the sub-Saharan African countryside, for example, people are often forced to bury the little money they have, because they have no access to a deposit service. If illness prevents the very poor from earning an income, or if they are victims of theft, they can rarely turn for help to state-provided welfare services, and private insurance is either unavailable or unaffordable. This means they often have no choice but to borrow. But the loans most readily available to them are offered by informal local money lenders and come with huge interest rates. Borrowing on those terms exposes people to endless repayments and highly unpleasant methods of debt-collection. Being in debt by itself can make one, in some cultures, less than respectable, and defaulting on a debt, particularly a debt to a money lender, can be far worse.

There is a need, then, for financial services for the poor that do not make their already dire circumstances worse. Microfinance is designed to be such a service. In its most familiar form, it is the offer of small loans to those with no financial assets. These loans – typically in the hundreds of dollars, typically repayable in a year – are offered by a range of institutions, most often for income-earning ventures. Some of the institutions are commercial, some are non-governmental organizations, some are state-funded, and others are part-funded or fully funded by Northern donor agencies. Interest is charged on what is borrowed, but at rates set below (sometimes considerably below) those of money lenders.

The essays in this book assess microfinance – not just loans, but savings and other financial services – as a means of relieving poverty. The frame of reference for this assessment is not only economic but moral. Although international financial institutions and an army of economists have examined the power of microfinance to lift the incomes of the poorest and the slightly less poor,[1] producing evidence that in many places microfinance does indeed increase the incomes of those who use it, this book is the first to bring to bear some of the resources of analytic moral and political philosophy. Contributors consider the relation of microfinance to human rights, the possible kinds and extent of exploitation in microfinance practices, and relations among poverty, freedom and money, as well as other significant moral issues.

The context of microfinance

Not all microfinance borrowers are extremely poor by the measure of an income between 1 dollar and 2 dollars per day. Many belong to a more inclusive group known as “the bottom of the pyramid” – those with an annual income of under $3000 (Prahalad and Hart 2002). Globally, between 60 and 130 million people are microfinance borrowers.[2] Not only banks or bank-like institutions are involved, and not all loans are for entrepreneurial purposes. Commercial and non-profit organizations also offer housing finance, school fees finance, health insurance and loans for temporarily unaffordable necessities. Large retailers such as Walmart have also tried to enter microfinance.[3] Recent estimates of the number of institutions involved in lending to the poor range from just over 1300 to around 3300 (Rhyne 2009). These include microfinance institutions serving the relatively poor in North America and Western Europe, generally within urban areas.

Microfinance institutions (MFIs) often combine loans with programmes of training and other forms of assistance, and even when they are commercial or profit-making, they typically define themselves as social businesses whose overriding goal is social change or improvement. Where profit seeking conflicts with the overall goal, or calls into question the organization’s commitment to it, an MFI is supposed to seek less profit, or aim only to cover its costs. As we shall see in some of the contributions to this volume, MFIs attract criticism when they appear to approach microfinance mainly as a method of expanding the customer base for mainstream banking so as to include the best-off of the poor.

1 A recent survey of a number of studies is N. Goldberg, *Measuring the Impact of Microfinance: Taking Stock of What We Know* (New York: Grameen Foundation USA, 2005).

2 Adrian Gonzales, “How Many Microfinance Institutions and Borrowers Exist?” gives an estimate of 77 million. Microfinance Information Exchange, September 2007, www.themix.org. 130 million was the figure arrived at by the Microcredit Summit, 2007 report. www.microfinancesummit.org

3 www.microcapital.org/microcapital-story-microfinance-through-wal-mart-banco-wal-mart-de-mexico-adelante-opens-in-mexico/

Such lenders receive criticism not only from anti-poverty campaigners and the public, but also from other MFIs.

The Grameen Bank and group lending

Perhaps the best-known microfinance institution is the Bangladesh-based Grameen Bank. It was founded in 1983 by Muhammad Yunus, who was recognised for his pioneering work in microfinance with the Nobel Peace Prize in 2006. The Grameen Bank is a profitable social business that earns all its revenue from loans. Borrowers hold 95 percent of its equity,[4] and it reports a halt to accepting subsidies from donors in 1998.[5] The rate of repayment of its loans in 2009 was just over 97 percent.[6] Grameen Bank customers are overwhelmingly female and are overwhelmingly based in rural areas. The bank reports making a profit in all but three years of its history. For example, in 2009 it made a (very modest) profit of just over $5 million[7] on total revenue of $209 million.[8] It offers loans through a network of more than 2000 branches, which in turn serve more than 8000 villages. Its average loan size is around $120. Loans are not its only financial service; it also takes deposits, and its savings accounts are interest-bearing.

A distinctive, and much-imitated and adapted, feature of the Grameen Bank approach to microfinance is its practice of lending to small groups of borrowers as opposed to individuals. In Bangladesh, loans are offered to two members at a time of a five-person "solidarity" group. The group members band together based on their sense of the others' reliability and cooperativeness. If people seem to manage themselves and their domestic lives well, they are a potential recruit to a group; otherwise, not. Each group has a leader, whose higher status sometimes reflects a locally acknowledged place in a pre-existing hierarchy.

Groups present themselves to a local Grameen Bank official and the group members selected for a loan explain why they want it. Yunus is no believer in simple hand-outs. The preferred purpose of a loan is investment in income-generating enterprise. The money can be used for buying agricultural stock or perhaps stock for modest street trading. If the loan is agreed, each person in the group, not just those who get

4 According to its website its profits in ews232009 were US $5.38 million.
5 www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=0
6 Ibid.
7 www.grameen-info.org/index.php?option=com_content&task=view&id=739&Itemid=711
8 www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175

the loan, takes responsibility for repayment and agrees to other conditions associated with the loan. These include weekly attendance at highly regimented meetings with fellow solidarity group members and the members of four other solidarity groups. The weekly meetings serve a number of purposes. Members of the groups are drilled in Grameen's "Sixteen Promises," including undertakings about saving, maintaining homes, growing certain crops and mutual help. The promises reflect the fact that a Grameen loan is not a financial transaction only, but an element in a wider programme of self-help at the level of a borrower in a village and their family. The goals of improving the family house, family nutrition and family agricultural practice are promoted on a weekly basis, and indicators of progress are monitored.

On the financial side, a portion of the loan is held back as compulsory savings for the group. Those who are not repaying a loan are responsible for keeping an eye and sometimes putting pressure on those who are repaying, to make sure that the loan conditions are met. Repayment is expected to take place in instalments each week, at the meetings. Those who are not repaying are expected to save a little, preferably also weekly, and to present these savings to the bank official at the meeting. Originally, the Grameen Bank required groups to guarantee the loans of members, that is, undertake to pay back the loan even if the group member who received it was unable to do so. Now the Grameen system has relaxed the conditions of the loan. Groups no longer guarantee loans, but they become collectively ineligible for credit if two weeks' repayments are missed.

The group lending method, including the institution of weekly meetings, works in theory to reduce risks for the bank and labour for bank officials. On the surface, microfinance directed at the extremely poor seems an intolerably risky proposition, because the borrower has little money and few saleable assets with which to secure the loan, turning the risk of default into an apparently probable outcome. Yet, while it may be true that the borrower has no *financial* assets, she may have skills and resourcefulness that will produce a return on an investment. Domestic life will probably have already made the typical woman borrower a good manager of time and a skilled multi-tasker. If she can also make saleable handicrafts or clothing, she is not necessarily a risky borrower. Women who are similarly skilled in these ways can identify one another from ordinary village interaction and form groups of the particularly capable. The part of the loan held back as compulsory savings reduces risk further, as do relatively high interest charges. Then there is the fact that the poorest group members tend to be risk-averse and to borrow least, helping to minimise the chances of default. Finally, there is the day-to-day peer-pressure that group members can bring to bear, and the embarrassment of public failure to repay at weekly meetings. Weekly meetings have further functions. They obviate time-consuming visits by bank officials to individual borrowers, or time-consuming individual appointments. They aid efficient record-keeping, because savings and loans data are collected weekly. All of these factors insulate Grameen-type microfinance from the risk of default, and without the need for the huge interest rates of the local money lenders.

Not all group-lending in microfinance follows the Grameen model exactly, and even some Grameen Bank lending, for example in the USA, uses group-lending arrangements of different kinds. Typically, group lending involves stricter group liability than is currently required by the Grameen Bank. Groups are usually collectively liable to repay the loans of individual members who default, and this sometimes creates pressures to repay that are reminiscent of money lending. On the other hand, weekly meetings are often dispensed with when MFIs depart from the Grameen model. In the Peruvian groups discussed in this volume by Ana Marr, groups must contain no fewer than 20 people (4 times the size of a Grameen "solidarity" group), and meetings are supposed to occupy only 10 hours per year, as opposed to at least 10 times that number in the Grameen model. Sometimes meetings are dispensed with altogether, leaving only joint liability (Harper 2007).

The drawbacks of groups, and other criticisms of microfinance

An important potential defect of the Grameen approach, which is a reflection of its strengths in the control of defaults, is its great demandingness. Group members have to make very considerable investments of time and energy in order to become eligible for a loan, let alone to get one and repay it. There are the weekly meetings, the discipline and sacrifice that may be necessary for setting aside savings when one is already extremely poor, the patience required to wait one's turn for a loan. All of this is in addition to the time and energy and co-ordination required for the enterprise that the loan is supposed to be invested in. If one considers that the borrowers are typically women who have heavy domestic responsibilities outside their entrepreneurial lives and often have to overcome the disapproval of men in running their businesses,[9] not to mention lack

[9] For an excellent discussion of the disputed question of whether men, particularly husbands, undermine women borrowers in microfinance, especially in South Asia, see Naila

of education and lack of money, the Grameen model can be seen as very demanding indeed.

Yet, the demandingness of the Grameen model is not a decisive objection to it in practical terms. In practice (at least in Bangladesh) people in great numbers cope with it. Is there, however, something morally wrong with a loan mechanism that occupies so much of people's time and attention? If there were an alternative that was equally effective in poverty-reduction, and that was easier for hard-pressed people to use, the alternative would be morally superior, other things being equal, because it would be making very hard lives easier.[10]

There are three further reasons for thinking that an alternative to the Grameen model is morally desirable, other things being equal. These correspond to the coercive aspects of group borrowing, the relatively high interest rates, and the psychological costs of being a debtor in some places. To begin with the psychological costs and coercion, under the Grameen model, members of a group take on debt publicly. Not only their fellow group members but their fellow villagers know that they have money to pay back. As noted, in many communities, having the status of debtor by itself makes one disreputable (Dichter 2007). Added to this are the regimentation of sitting in lines before a bank official, and the ritual of singing songs (Harper 2007). Then there is the pressure, self-imposed and imposed by the group, of repaying 52 times a year. Being in debt by itself may not be stigmatizing everywhere, especially if all goes smoothly with repayments, but if people fall behind and are put under pressure by their group, that pressure is public and can be humiliating. Sometimes it can lead to suicide.[11] Even if it were not humiliating, pressure on group members to repay may be disproportionate, verging on harassment. In some versions of the group model, the following practices are known to take place: "holding the weekly meeting in front of the defaulter's

Kabeer, "*Money Can't Buy me Love?" Re-evaluating Gender, Credit and Empowerment in Rural Bangladesh* (Institute of Development Studies, University of Sussex, 1998). Kabeer argues persuasively that women in this context are net beneficiaries of microfinance. In the same vein, see Mark Pitt, Shahidur R. Khandker, and Jennifer Cartwright, "Empowering Women with Micro Finance: Evidence from Bangladesh." *Economic Development and Cultural Change* 54(4): 791–831, 2006; and Paromita Sanyal, "From Credit to Collective Action: The Role of Microfinance in Promoting Women's Social Capital and Normative Influence." *American Sociological Review* 74(4):529–50, 2009.

10 Easing the already easy life of the pampered rich person may have *no* moral value.

11 See "Learning from the Andhra Pradesh Crisis" in T. Dichter and M. Harper, eds., *What's Wrong with Microfinance?* (Bourton on Dunsmore, UK: Practical Action Publishing, 2007), p. 169. Admittedly, properly documented cases of suicide from debt default are not often cited.

house; . . . staff [from the microfinance institution] sitting in front of the defaulter's door; offensive language used by group leaders or staff; putting up a loan overdue notice in front of a defaulter's house."[12]

The burden of high interest rates is at first sight another moral objection to the Grameen model. The interest rates charged to the poorest in Bangladesh under that model are two or three times the interest rates charged by mainstream banks. Some microfinance institutions in other countries charge much higher interest rates than 35 percent, often unashamedly for the sake of maximizing their profits from microfinance. The Mexican microfinance institution Compartamos is the leading example.[13] But even where the interest rates are only two or three times those of commercial interest rates, are they not too high, and, in any case, so high that they sit uneasily with a would-be role for microfinance as an instrument of human rights realization for the poor? These issues are well-represented in the essays that make up this book.

The essays

The essays fall into three main groups: a sequence on rights and microfinance; a pair of chapters on microfinance and justice; and a sequence on the ways microfinance might worsen the plight of the poor or exploit them, based on problems with group lending and interest rate charges.

Rights and credit

The opening sequence, made up of essays by Gershman and Morduch, Sorell, and Brownlee and Stemplowska, is concerned with the relation of microfinance to rights. Muhammad Yunus has claimed that, in view of the poverty-alleviating powers of credit, the poor have a right to credit, perhaps even a human right. There is a reputable philosophical following for the claim that there is a human right to be spared extreme poverty (Pogge 2007). A right to credit as a means of leaving poverty might be philosophically defensible as well. Gershman and Morduch doubt that Yunus's insistence on a human right to credit is either rhetorically or empirically well-judged. Giving too many interests the status of human

12 Ibid.
13 Compartamos has been heavily criticised in the microfinance world for abandoning even the veneer of a social business. See http://rjverbrugge.net/development/NYTimesMicrofinanceCritique.pdf

rights lowers the status of human rights. It is easy to blunt the authority of claims in the name of human rights if the threshold for counting as a human right is set too low. Anyway, some human rights are to be fulfilled only subject to the relevant resources being available, and microfinance may be subject to this conditional obligation, if to any obligation at all. Next, Gershman and Morduch point out, microfinance in the form of a loan for entrepreneurial activity does not necessarily have positive effects. The evidence is mixed, varying according to such factors as region and gender of the borrowers. Yunus further complicates the case for a human right to credit by his general scepticism toward state-intervention, particularly in the form of direct cash transfers to the poor. Not only can such transfers sometimes be beneficial, Morduch and Gershman argue, but anti-statism does not in general sit well with support for human rights. On the contrary, it makes harder to answer the question of who is obliged to offer credit, on what grounds, and at what possible financial cost.

There might be a human right to credit if credit in general, and microfinance in particular, were a good way of alleviating extreme poverty, and there was a right to be spared extreme poverty. But Sorell throws doubt on this line of thought. Because of indeterminacy in the relative legal and moral content of the concept of a human right, it is debatable whether extreme poverty is always and everywhere a human rights violation, as opposed to an injustice more generally. Furthermore, microcredit is not necessarily an effective or morally appropriate way of alleviating extreme poverty because of the way groups sometimes work, and human rights duty-bearers in the area of extreme poverty do not include most existing microfinance providers. A further point is that the concept of human right has to be interpreted implausibly widely in arguments for the existence of a human right to be spared extreme poverty.

Whether or not there is a human right to microcredit, a human right to financial inclusion might make sense, according to Brownlee and Stemplowska. For there is a human right to education, and a right to financial inclusion would be structurally similar to that. One apparent disanalogy between the human right to education and the right to financial inclusion is that the former is unconditional, while the latter might be thought to be conditional on displays of financial prudence. Brownlee and Stemplowska argue that the supposed disanalogy here depends on morally questionable practice in microfinance: it is too much for the poor to be required, as they are routinely required in microfinance, to cultivate the kind of character that amounts to collateral. This reintroduces the suspect notion of deserving poor, and with it the now discredited distinction between those who deserve and don't deserve to be poor.

Justice

Sorell suggests that the concept of justice may apply more straightforwardly than that of human rights in justifying the relief of extreme poverty, and, more specifically, justifying the relief of extreme poverty by means of microfinance. Two essays – by Ronzoni and Valentini, and by Butt – apply the theory of justice to microfinance. Ronzoni and Valentini distinguish various kinds of justice that microfinance might promote, and they conclude that what microfinance promotes best is political justice. To pursue political justice is to undo imbalances in power. One way this can be done is by empowering the worst off. Empowerment can come about by reforming global economic and political structures, but there are also local channels for it, including microfinance institutions. Ronzoni and Valentini do not believe that MFIs in their current form are well designed for the kind of empowerment that MFIs promise in principle. Their claim is rather that *reformed* MFIs can have an empowering role. The beneficiaries of reformed MFIs are not just borrowers taken one by one, but the societies to which these borrowers belong, through the help provided by their middle classes.

Rather than defending or opposing microfinance schemes in a general way, Butt seeks to outline the particular complexities that attach themselves to judgments of microfinance schemes in non-ideal contexts characterised by extreme background distributive injustice. Such injustice has the dual effect of (i) calling into question forms of interaction that would be unproblematic in circumstances of broad distributive justice; and (ii) raising the costs of prohibiting such interaction, particularly when it helps individuals to attain a minimum level of well-being. Butt considers different forms of microfinance provision in both ideal and non-ideal contexts, and a number of different accounts of distributive justice, in order to assess the justifiability and legitimacy of a range of real-world microfinance institutions. He concludes that some microfinance institutions should be viewed as unjust, but not necessarily prohibited.

Groups, interest rates and exploitation

The next sequence of chapters – by Sherratt, Sandberg and Marr – reintroduces the moral dimensions of risk-reduction through peer pressure and joint liability in microfinance. Microfinance may involve exploitation, Sherratt says, because the very poor have impaired autonomy and are trapped between no credit and very expensive credit. Not only do they have to overcome more obstacles than other, richer people, to get access to credit, but once they receive it, they are subject to extraordinary pressures to repay, and are even expected to put pressure on fellow borrowers to repay as well. Some of these extra burdens result from the sometimes misleading ways in which microfinance institutions calculate and advertise interest charges. Interest charges are consistently understated, and often they are many times the levels charged by mainstream banks, as Sherratt shows by two methods of calculating rates from different available international databases. Further burdens on poor borrowers result from the widespread use of the group-lending model. Sherratt argues, however, that though microfinance is exploitative, it does not follow that it is impermissible. On the contrary, it may be better on balance to retain than to reject an exploitative practice of microfinance if microfinance helps to relieve poverty. But in that case, it is important to minimise the exploitation as far as possible. Two ways of doing so, she suggests, are by moving away from group-based to individual microfinance, and by reducing the money cost of microloans.

Sandberg focuses on the possible injustice to poor borrowers of high interest rates charged by microfinance institutions. MFIs in general charge higher interests than the formal banking sector, but some MFIs charge interest rates that are extremely high even by the standards of microfinance. The most notorious case is that of Compartamos, the Mexican MFI whose interest rates are as high as 100 percent, compared to between 30 and 40 percent for mainstream MFIs. Compartamos' rates are high enough to impugn any claims it might make that its main aim is to reduce poverty. But other MFIs are not in this position. Their rates are closer to the barer requirements of sustainability. So, although their interest rates are higher than those of the formal banking sector, they are not necessarily exorbitant.

Sandberg rejects an argument from practice that is sometimes used to show that interest rates are not exorbitant. The argument can be put as follows. "Poor people actually succeed in repaying their loans, even at supposedly excessive rates, and they come back for second and third loans. What is more, demand for loans exceeds supply. Since no-one forces them to take these loans, and since poor people know what obligations they are taking on, there is no injustice or exploitation in their agreeing to and abiding by the terms of the loan, including repayment at high interest rates." In response, Sandberg points out the pressures of group lending, and the scope that MFIs themselves have for lowering interest rates through cutting costs. The peer pressure and the costs can both be reduced, which suggests that, even though borrowers live with both, they shouldn't have to.

Ana Marr provides criticism of group lending from an entirely different direction. Her argument against groups is not the moral one that is