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Borrower Protests
and the Failures of Microfinance in Nicaragua

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Borrower Protests
and the Failures of Microfinance in Nicaragua

by

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Dedication

Para mi esposo, Johnny, y mi hijo.

I dedicate this thesis to my husband, Johnny, for his patience, support and sacrifice and for making my academic work a priority in our lives. Thank you for being at my side every step of the way. Gracias por tu paciencia y tu apoyo, mi amor.

Y mi hijo, John, te adoro.

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Abstract

Borrower Protests and the Failures of Microfinance in Nicaragua

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Abstract: For over two decades, development practitioners, scholars, and institutions have celebrated microfinance—broadly defined as the provision of small-scale financial services to the world's poor—as an effective tool for poverty alleviation and local economic development. Critics of microfinance, however, suggest that there is little clear evidence to support the claims that microfinance lifts the poor out of poverty and fosters local economic development. In this thesis, I explore some of the challenges to microfinance in northern Nicaragua by exploring a case study of a group of borrowers who have confronted microfinance and exposed some serious problems. Since 2008, thousands of microcredit clients in Nicaragua have expressed their extreme frustration with microfinance and its detrimental effects in their lives. In this case, Nicaraguans caught up in the microfinance scheme risk losing their homes and livelihoods and falling into greater poverty. These borrowers, organized as *El Movimiento de Pequeños Productores, Comerciantes y Microempresarios del Norte* (the Movement of Producers, Merchants and Small Business Owners of the North), demand new terms on their

microcredit debts and new client protections. I explore the reaction and the demands of these borrowers and their direct and indirect critiques of the microcredit sector, its practices and its alleged goals. I argue that the resistance of the MPCN reveals the political and economic rationale and neoliberal ideology behind microcredit as a poverty alleviation intervention, and their contestation challenges its underlying logic. These critiques and demands provide us with a foundation for rethinking the prevailing market-oriented approaches to development.

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Introduction

For over two decades, development practitioners, scholars, and institutions have celebrated microfinance—broadly defined as the provision of small-scale financial services to the world's poor—as an effective tool for poverty alleviation and local economic development. Microfinance advocates have envisioned and marketed modern microfinance as a worldwide "movement" to help the poor lift themselves up by the bootstraps and out of poverty (Daley-Harris 2002; Yunus 2007 and 2010; Smith and Thompson 2007; Bornstein 1997; McLeod Arnopoulos 2010). With its current emphasis on creating sustainable lending programs, microfinance has been credited as a "win-win" approach to development: the poor have access to financial resources to improve their standard of living through the market, and development partners make a profitable return on investment (Kalpana 2005). Claims of the potential to generate household income, promote employment and productive activities, stimulate local bottoms-up development, and empower the poor through sustainable and profitable microfinance institutions (MFIs) have elevated microfinance to one of the primary interventions in international development policy (Rankin 2001; Bateman 2010).

In 2009, the Microfinance Information Exchange (MIX) reported on 1,935 MFIs worldwide that served 92.2 million client borrowers and held US$65 billion in gross loan portfolios (MIX 2010). The World Bank, the United Nations, USAID, regional development banks such as the Inter-American Development Bank (IADB), bi- and multi-lateral development agencies, a number of third world state governments, and even some first world commercial banks have rallied behind microfinance. Large foundations, such as the Ford Foundation and the Bill and Melinda Gates Foundation, have lent

financial and technical support to microfinance efforts around the world. Wealthy philanthropists such as George Soros and eBay founder Pierre Omidyar have pledged millions of dollars to support microcredit, and high-profile political figures and Hollywood stars have drawn in the public's fascination with the model. With the development of internet-based peer-to-peer platforms like Kiva.org, individuals can get involved and lend even a few dollars to a microentrepreneur in a developing country. In the past decade, the appeal of microfinance and its promises have solidified its fashionable role in the developed/donor world.

Critics of microfinance, however, suggest that there is little clear evidence to support the claims that microfinance lifts the poor out of poverty and fosters local economic development (Bateman 2007 and 2010; Ellerman 2007; Dichter 2006; Karmini 2007; Rosenberg 2010; see other critiques in Dichter and Harper 2007). Rather, critics caution that microfinance has the serious potential to harm its clients with some borrowers falling into greater poverty and facing other negative outcomes. A few critics also question microfinance's role in the path to economic development and have suggested that microfinance may in fact interfere with the very possibilities for real long-term economic growth (Bateman 2010). In this thesis, I explore some of the challenges to microfinance in northern Nicaragua through a case study of a group of borrowers who have confronted microfinance and exposed some serious problems.

Since 2008, thousands of microcredit clients in northern Nicaragua have expressed their extreme frustration with microfinance and its detrimental effects in their lives. In the case I present in this thesis, poor and non-poor Nicaraguans caught up in the microfinance scheme risk losing their homes and livelihoods and falling into greater poverty. For three years, borrowers, organized as *El Movimiento de Pequeños Productores, Comerciantes y Microempresarios del Norte* (the Movement of Producers,

Merchants and Small Business Owners of the North), MPCN, have marched through the streets of their communities and the capital, formed disruptive road blockades, and planted themselves in front of MFI branches and government buildings to demand new terms on their microcredit debts and new client protections.

The political force of the protests has destabilized Nicaragua's microcredit sector: default rates have risen, resources and lending have tightened, and microfinance institutions have closed (Alemán, Álvarez, and Vanegas 2008; Galeano and Aleman 2009; Martînez 2009; Álvarez Hidalgo 2009; Núñez 2009; Núñez, Marenco, and Potosme 2010). The tensions have spurred new discussions about the role and structure of private microcredit and the state in the national financial markets. In response to the protests, microcredit leaders and international donors and investors have attacked the MPCN and vocally defended their standard practices and their significant role in providing credit resources to Nicaragua's underserved (Nuñez 2010a; Álvarez Hidalgo and Nuñez 2009; Núñez Roodman 2009). The Nicaraguan government, through various different actors and at different times, has taken complicated and often contradictory positions in relation to the MPCN, the microfinance sector, and its own role in the provision of credit to the poor.

The goal of this thesis is to explore the reaction and the demands of these borrowers and their direct and indirect critiques of the microcredit sector, its practices and its alleged goals. I argue that the resistance of the MPCN reveals the political and economic rationale and neoliberal ideology behind microcredit as a poverty alleviation intervention, and their contestation challenges its underlying logic. These critiques and demands provide us with a foundation for rethinking the prevailing market-oriented approaches to development. Ultimately, I suggest that the predominant model of microfinance serves as an integral part of the hegemonic neoliberal economic project.

As anthropologist Aminur Rahman argues, "There is a growing fascination with the mechanics of microfinance, with the vehicle. There is less and less concern about the passengers and their destination" (quoted in Lont and Hospes 2004:3). By sharing some of these borrowers' stories—which are sorely lacking in the present discourse on microfinance—I hope to uncover something more about these passengers and their understanding of microfinance and its repercussions in their lives, and to deepen the discussion of microfinance and its consequences for the world's poor. This thesis is my interpretation of the reaction of a group of people against the microfinance sector in Nicaragua and, more generally, against the economic abandonment in which they live. I locate theoretical and practical critiques of microfinance, specifically related to its complex relation to the economic exclusion symptomatic of the greater neoliberal capitalist structure and the limitations of its vision for poverty alleviation.

Part of this story reflects the specifics of the way in which microfinance has developed and functions within its context in Nicaragua. Despite the contextual particularities, I suggest that the resistance to microfinance in Nicaragua speaks to growing contestation—from borrowers, lenders, professionals, and academics—that is beginning to shake the base of the microfinance bandwagon.

RESEARCH METHODS

In July 2008, I stood in line to exchange currency in a branch of Banco ProCrédit, a microfinance institution in a semi-rural town in northern Nicaragua. Within a matter of minutes, some 50 or 60 protestors barricaded the front of the building and blocked the employees and clients, including me, from exiting. People waiting in the lines turned to see the demonstration and mumbled under their breath, but quickly quieted. Days later,

another demonstration ended in police confrontation and violence and, in response to the tense situation, microfinance institutions in the area shut their doors and ceased operations for several days. When I returned to the United States shortly thereafter, headlines in the national press recounted the continued demonstrations against local microfinance institutions. Curious to understand the nature of the protests, I spent the following year tracking news coverage of the MPCN's demonstrations and their legal demands.

As I followed the protests from a distance, I began to develop a critical understanding of the protest against microfinance and what I saw as a larger struggle against the neoliberal capitalist system. I entered the field again one year later armed with my budding analysis and excited to exchange these ideas with the borrowers in the movement. But instead I was met with a general lack of a similar vision or analysis, and my ideas of resistance were challenged. Not only had I assumed that in the situation of domination and inequality, there would be resistance, but that this resistance would take particular forms, would hold particular ideologies, and would more certainly imagine the overthrow of oppressive systems and forms of domination. My disorientation in the field raised a number of interesting questions about resistance. How do we understand local instances of resistance when they are not tied to ideologies of liberation or the overthrow of larger systems of domination? What do these forms of resistances reveal about the complexity of the relationship of resistance to power? What are the methodological and analytical implications? How can I balance my political alignment to the movement I study with my commitment to scholarship and analytical advancement?

Informed by the major theoretical contributions to the theories of power, resistance, and revolution put forth by Marx and Gramsci, scholars of the 1960s and 1970s produced studies of resistance of large-scale peasant rebellion and revolution.

Shifting directions, later scholars turned their concerns to other unlikely instances of resistance—local, small-scale, unorganized, or those that function without a seeming attempt at overthrow of systems of oppression and domination—and expanded our notion of resistance and the many, complex forms it could take. The later ethnographic work of Scott, *Weapons of the Weak: Everyday Forms of Peasant Resistance* (1985), is a good example. Scott argues against what he sees as a trend in the literature to overemphasize peasant rebellions and revolutions and, instead, analyzes the everyday forms of Malaysian peasant resistance, the commonplace ways in which peasants historically have defended their interests in a constant, grinding struggle. Scott grapples with whether or not everyday forms of resistance, seemingly unorganized and incoherent and mobilized for immediate, pragmatic, modest gains, are "real" resistance and whether resistance must have as its goal an overt negation of the system of domination to count. For Scott, these unlikely forms are resistance. Such as the moments for a wide-spread rebellion or revolution are historically quite rare, and often crushed, these forms of everyday resistances may very well be the subordinate class's only option as a sheer matter of the historical, political, economic context.

An expansive definition of resistance allows scholars to consider other actions, discourses, and forms of resistance that may not fall within earlier theories of rebellion and Marxist-style revolution. In analyzing everyday or other unlikely forms of resistance, the challenge for scholars is to examine these acts of resistances as such and understand them within the their own terms and historical specific context, especially when, as Scott suggests, revolution may not be an option. In doing so, we can further complicate earlier reductionist theories and uncover the varied ways resistance works. The caution for scholars here is to examine resistances that may not tie to greater ideologies of liberation and to take care not to trivialize them inappropriately, reduce them to concepts such as

"false consciousness," or present them as misguided or underdeveloped in comparison with revolutionary movements. To begin to address these concerns, scholars must develop the relationship of these types of resistance to power and the forms of domination that shape, define, and confine what resistances may look like.

In her ethnographic work with Bedouin women, Abu-Lughod (1990), finding unlikely forms of resistance, argues for a significant theoretical shift in the way scholars continue to understand resistance and its relation to power. By reading resistance as the ineffectiveness of power and the refusal of domination, "we collapse distinctions between forms of resistance and foreclose certain questions about the workings of power" (1990:42). Abu-Lughod takes up Foucault's widely known, abbreviated proposition, "where there is power, there is resistance" and inverts it: "where there is resistance, there is power" (1990:42). Though perhaps a more obvious claim, the switch assumes that there is resistance, and from that vantage point, allows us to reconsider the ways in which certain forms of resistance can serve as a diagnostic of domination and power. This theoretical shift requires us to open our analysis to the complex ways resistance and power function and interact.

In his ethnography, *Disparate Diasporas: Identity and Politics in an African-Nicaraguan Community* (1998), Gordon candidly reveals his own disorientation when his theoretical leanings and political agendas, formed in his scholarly and political training in the United States, were not met with an expected shared engagement from either within the Sandinista Revolution or the Nicaraguan Creole populations. Looking beyond his pre-developed conceptions of resistance and racial identity, Gordon's careful analysis of the history and identity formations of Creole populations in eastern Nicaragua revealed a "common sense" seesawing between accommodation and resistance as the Creoles reacted to the Sandinista state. Gordon's work suggests that, as scholars, we can navigate

and distinguish between respect for the specifics in context of resistances and our own political and analytical lens. Had Gordon (or I for that matter) insisted on pursuing a pre-developed political project or held tightly to an analysis, he would most likely have overlooked the particular histories, local factors, and forms of power that shape resistance.

However, this does not mean that the theoretical and political understandings of the scholar in the field are invalid or that they will not, or should not, be part of what might be shared with those who are resisting inequality and oppression. The objective for the scholar is to find a productive balance, both in the field and in scholarship, between the reality of resistance and his or her commitments to a particular politics and scholarly contributions. In my own work, the questions raised by my initial experiences in the field have challenged me to reconsider my methodological and analytical efforts in my approach to understand and work with the borrowers in protest. I analyze the protests and legal interventions of the movement against the microfinance institutions as practical, local resistance against a locally operating (though globally tied) system of power. The forms of resistance in this case are established to achieve concrete individual results (the renegotiation of loan terms for desperately indebted clients) and system-wide changes in the national microfinance industry (legal restriction on high interest rates, seizures of property, and incarcerations). Though the resistance does not take form like I had initially imagined, or romanticized, I continue to align myself politically with the movement in its quest for important and time-sensitive goals.

In my commitment to scholarship, I find it productive to consider what these forms of resistance might expose about the complicated, varied forms of domination taking place and the way people are caught up in them. I understand the struggle of the MPCN as symptomatic of the relationship of microfinance to the oppression

characteristic of global neoliberal capitalism. Perhaps in some way this interpretation might be of some use to the struggle. What I hope to accomplish, in the end, is a balance between a thorough and respectful representation of the nature of the resistance of the movement and an analysis of the forms of resistance and domination at play.

In preparation for fieldwork in the summer of 2009, I followed the regular news coverage of the demonstrations of the MPCN, their legislative battle, and the reactions from the microfinance sector in Nicaragua's two major national newspapers, *El Nuevo Diario* and *La Prensa*. Through this and other archival research, I reconstructed a timeline of the early demonstrations and actions of the MPCN. I also began to collect some of the stories, arguments, and demands of protestors and leaders of the MPCN interviewed for the press. Similarly, I noted the arguments of representatives of the microfinance industry who articulated their position to the press as well as that of different state actors who participated in the debate. I also began researching Nicaragua's history of economic development, particularly the microfinance sector and credit, to piece together the historical, political, and economic context to the present borrower crisis.

I returned to northern Nicaragua for three months in 2009. I conducted open-ended interviews and limited participant observation with borrowers who participate in the MPCN. I introduced myself to one of the regional leaders of the MPCN, Jose Padilla, who lives in the community where I stayed, and I interviewed with him in his home. I asked him about the demands and goals of the protests, the proposed legislation, and his perspectives on microfinance as economic development in general. He invited me to travel with him and a group of debtors to Managua to participate in one of several large demonstrations at the National Assembly in Managua in July 2009. In addition, I was invited inside the Assembly and into the observation room to witness the beginnings of a

debate on pending legislation in favor of renegotiations of the debts of the MPCN participants.

During a four-hour drive and six-hour stand-in at the Assembly, I met dozens of borrowers. I took the opportunity created by my attendance at the large demonstration to solicit and conduct interviews with a select variety of participants. If I had not had the chance to meet MPCN participants in this way, I would have had to rely on the snowball method to obtain interviews, beginning with Mr. Padilla, and I would have had less opportunity to select different participants reflecting range of sex, occupation, and place of residence. Nonetheless, my interviewees were limited to those whom I met at the protests that day and exclude other borrowers who did not travel and participate the demonstration in Managua.

Of the dozens of participants I met, I selected the interviewees based on gender and occupation or enterprise. Although I did not specifically ask about economic status, or select interviewees based on their economic position, I generally separated interviewees by those with relatively small business activities and those with somewhat larger productive enterprises. I spoke at length with seven borrowers who participated in the MPCN. The regional leader and two other male interviewees were landowners with small to medium-sized farms, and two other male interviewees were agricultural workers. Two of my interviewees were women who owned established businesses selling goods, and one other interviewee was a woman who sold products in the local market. Three interviewees were from the semi-rural town in which I stayed, and the others were from other areas in northern and central Nicaragua. I spoke informally with these seven participants about their debts, their challenges, and their perspectives on credit as well as their motivation to participate in the protests and their hopes for a resolution.

In addition to interviews with the protestors, I sought interviews with three managers of local branches of MFIs in one of the towns with a high level of protest targets. In one case, I cold solicited an interview by simply entering the MFI branch and introducing myself to the manager and explaining my research topic in general terms. We spoke at some length in her office, and while I asked several questions in regards to the protests and their claims, the manager was unwilling to speak about the topic. The interview focused on the mechanics of that specific MFI's loan products and the manager's perception of the role microfinance plays in the community. I relied on my personal social network to try to engage two other MFI managers; however, my requests for interviews were not granted.

I also interviewed two local community news reporters who had covered the demonstrations. Both reporters, middle-aged men, recounted what they had witnessed and reported in regards to the MPCN protests. As long-time political reporters, they both drew wider connections to the national political and legal context as well as some historical antecedents to the crisis. These perspectives helped me to broaden my understanding and the scope of my analysis of the demands and motivations of the protestors, the MFI and community reactions, and the larger political and economic context around the microfinance industry in Nicaragua.

Returning from the field, I monitored daily *El Nuevo Diario* and *La Prensa* online to track the coverage of the MPCN demonstrations and the path of the proposed legislation up to the summer of 2010.

In the first chapter, I briefly introduce and outline the historical development of modern microfinance, its main principles and goals, and the more recent global trend prioritizing the financial sustainability of microfinance institutions. I also outline some of the more recent practical, theoretical, and ideological critiques of the microfinance

phenomenon. In the following chapter, I discuss microfinance as a discourse that supports neoliberal capitalism. I highlight the narratives of microfinance, the knowledges it produces, its position in economic system, and the subjectivities it creates. In the third chapter, I outline the history of economic development in Nicaragua from the 1980s Sandinista efforts to restructure the economic system to the post-1990 transition to the neoliberal capitalist-based approach to development. I focus in particular on the history of the provision of small-scale credit to target poor groups and the political shift from state-led distribution of credit to private institutional credit in the neoliberal era. In chapter four, I explore the development of microfinance in Nicaragua and the state of the microfinance sector, including some of the challenges and debates, to provide the context to the case study. In chapter five, I tell the story of the MPCN and detail their demands and proposals for change to the current system of small-scale credit. Then, I briefly describe the responses from the state and from the microfinance sector to the protests and legal demands. Finally, in the last chapter, I offer a discussion of the case of the MPCN and its significance for microfinance and market-led development.

I have created pseudonyms or otherwise not used the names or any identifying information of the people participating in the MPCN. Some of the indebted persons participating in these protests do face the real risks of losing their homes and livelihoods. I am also sensitive to some of the negative public "shaming" against those who are not paying their debts. All translations from Spanish are mine.

Chapter 1: What is Microcredit?

THE BEGINNINGS

The provision of small loans to low-income individuals for small-scale, income-generating activities is not a recent phenomenon. Small-scale finance for the poor has a long history and can include a variety of formal and informal structures, from moneylenders to state banks. Indigenous informal credit and saving associations have been identified in many societies; for example, anthropologist Clifford Geertz wrote about indigenous credit and savings associations in the 1950s (Geertz 1956; Bouman 1983). In the 1700s, Jonathan Swift inspired the creation of the Irish Loan Funds, which provided small loans to poor persons without collateral by requiring cosignatories and short-term weekly repayments (Hollis and Sweetman 2004). In the late 1800s, German Wilhelm Raiffeisen developed more formalized, member-owned rural credit unions to deliver credit to poor, often non-literate persons—a model that expanded through Europe (Shaffer 1999). In 1959, Akhtar-Hameed Khan through the Pakistan Academy for Rural Development developed cooperative community-based projects and group lending credit models, and in 1972, the Self-Employed Women's Association (SEWA), a trade union, founded a cooperative bank to lend to its members (Khan 1985).

Still, it is Bangladeshi economist Dr. Muhammad Yunus who is most widely credited as the pioneer of modern microfinance (United States Congressional Record 2007; Dugger 2006; Smith and Thurman 2007; Counts 2008; Islam 2007; BBC News 2006). The origin of microfinance is now a well-known story (Yunus 1994 and 2007; Counts 2008; Islam 2007). In the 1970s, Yunus, economics professor at Chittagong University, witnessed the devastation from war and famine in Bangladesh and its toll on

poor communities. Shocked by the overwhelming poverty, Yunus made regular visits to a neighboring low-income community where he observed poor women attempting to make a living by means of small-scale activities—raising chickens, making wooden stools, or selling food. These women, however, were unable to raise the level of capital needed to expand their activities and potentially increase their income and standard of living. When they did seek a loan from the informal option available to them—the moneylender—the terms of the loans and high collateral requirements and interest rates prevented the poor from making significant investments. He concluded that the greatest factor constraining the poor from working their way out of poverty was this lack of decent, low-cost capital to invest in their business activities. What these women needed were small, low-interest loans to invest in their businesses. Yunus begin an experiment in which he would provide small loans to the poor village women with no or little collateral. Yunus asked the women of the community to add up what they owed to the moneylender—40 loans for a total of $27. He paid off the moneylender, assumed the loans, and thus began his microlending program, the Grameen (meaning "village") Bank.

During the first few years, Yunus developed the terms of these "micro" loans and the delivery and recovery techniques. Yunus insisted on affordable interest rates for the borrowers so that poor entrepreneurs could reasonably invest and make enough profit to increase their household income and have a real chance of rising out of poverty. In the earliest years of the experiment, Grameen's loans were structured with small weekly repayments, beginning one week after the loan disbursement, with an interest rate of 20 percent. Grameen Bank required borrowers organize themselves in six non-related person support groups, called "solidarity circles." The group aspect provided Grameen with several advantages. Members of the groups carefully self-selected responsible, reliable group members, and weeded out other individuals who may not have proven to be

"creditworthy" clients. The group members collectively approved one member's proposal and request for a loan. Loans were disbursed to two members of the group at a time, and pending timely repayments, loans would be distributed to two additional members. If one member of the group defaulted, all members were held jointly liable. The group dynamic provided the peer pressure to ensure full and prompt repayment of loans and to ensure access to future loans for all borrowers in the group. The group self-selection and approval process and the social pressure to repay provided "social collateral" in place of physical collateral guarantees and lessened the credit risk for Grameen.

From the beginning of the project, Yunus focused in particular on female borrowers. Yunus argued, and continues to argue, that women ought to be the focus of poverty alleviation programs because women experience poverty more intensely than men and improvements in the economic and social conditions of the household are greater when the process of change is initiated through the woman head of household (see Yunus 1994 and 2007). Women, Yunus argues, are better fighters against poverty: they are willing to make sacrifices and work harder to lift their families out of poverty and protect their and their children's future and dignity. Moreover, women are more responsible and cautious, and therefore more capable and likely to repay.

In terms of repayment, the poor, especially poor women, turned out to be good credit clients. Yunus boasted a near perfect repayment rate (as high as 98 percent) as proof that his model worked and that the poor were bankable. Moreover, with such high repayment rates, Yunus argued that the Grameen Bank had the potential to function without donor subsidy as a financially viable institution. Witnessing the reported success of the Grameen Bank, development practitioners and donor agencies hailed the unique microlending techniques developed by Yunus as "revolutionary" in terms of successfully overcoming traditional barriers to lending to the poor through potentially sustainable

institutions (Islam 2007). Yunus promoted microcredit as a poverty reduction and development policy and program to the international donors, and by the end of the decade, the development community had taken special interest in the potential of microfinance.

Alongside the development of the Grameen Bank, other institutions began their experiments with microfinance for the poor: the Bangladesh Rural Advancement Committee (BRAC) and the Bank Rakyat Indonesia (BRI) in 1972 and ASA in 1978. The Latin American NGO ACCION established a microfinance program, PRODEM, in Bolivia in 1986. Since the 1980s, other Grameen-like programs have been developed in countries around the world. The Grameen lending model is often cited as an "ideal" model and credited as the best success story in microfinance industry and in the public imagination (Counts 2008; McLeod Arnopoulos 2010; Islam 2007). The Grameen model techniques—particularly the group or solidarity lending model, small loans with immediate and short-term repayment schedules, and the major focus on women clients—have dominated microfinance methodologies over the past 20 years (Islam 2007).

Muhammad Yunus remains the public face of microfinance and the Grameen Bank is a major force in the global industry. In 2006, Yunus and the Grameen Bank were jointly awarded the Nobel Peace Prize "for their efforts to create economic and social development from below." The press release from the award reads, "Lasting peace can not be achieved unless large population groups find ways in which to break out of poverty…. From modest beginnings three decades ago, Yunus has, first and foremost through Grameen Bank, developed micro-credit into an ever more important instrument in the struggle against poverty" (Nobelprize.org 2011). In 2010, according to MIX data, the Grameen Bank served over 8.3 million active borrowers and held a loan portfolio of over US$939 million (MIX 2011).

The Principles and Goals of Microcredit

Microfinance is broadly defined as the provision of financial services, predominantly credit, to poor borrowers for the purpose of investments in small-scale business activities or microenterprise.[1] Supporters present microfinance as an alternative intervention in an imperfect credit market created by the failures of both formal (commercial banks) and informal (the moneylender) credit sources to meet the financial needs of the poor. Traditional commercial banks' loan programs tend to exclude poor and rural populations due to the high risk and high costs associated with lending to these groups (Armendariz and Morduch 2005). In the absence of traditional bank credit, a poor person seeking access to capital may turn to other informal sources of credit, such as family or other social networks, or the local moneylender. The moneylender, often a member of the same community as the borrower, has the advantage over traditional banks: easy access to information about the borrower and the ability to exert social pressure and other tactics to ensure repayment. In microfinance literature, moneylenders are represented as exploitative monopolists squeezing the poor with excessively high interest rates and aggressive, controlling contracts (Yunus 1994; Smith and Thurman 2007; Armendariz and Morduch 2005).[2] Reports of annualized interest rates of 60, 70 and up to 159 percent charged by informal moneylenders support the claims about the

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[1] "Microfinance" refers to a range of financial services, such as credit, savings, insurance, and money transfers. The overwhelming majority of the microfinance sector is dedicated to the delivery of microcredit, although there has been a more recent push to expand services to include savings and insurance for the poor where possible. For this thesis, I use the two terms, microfinance and microcredit, interchangeably.

[2] Whether moneylenders are exploitive or are offering valuable, quick financial services for many people in their community is debated in Armendariz and Murdoch (2005). Some reports suggest that the availability of more formal finance does not replace the role of informal moneylenders and moneylenders play a significant role in money lending within their communities (Ghate 2007; Choudhury 2000).

negative role of the moneylender in the credit market for the poor.[3] Microfinance provides the poor with the option of a more formal or institutional, and ideally lower cost, source of credit than informal moneylenders.

Microfinance practitioners and supporters claim that microfinance credit offers the poor the opportunity to escape poverty by investing in small income-generating activities (Yunus 1994; Armendariz and Morduch 2005). With a lump investment, advocates argue, the poor have the potential to significantly increase labor, production and output, and therefore household income.[4] The higher income they can potentially earn can be used both to repay the loan and reinvest in the micro-activity to create a virtuous cycle: low income, credit, investment, more income, more credit, more investment, and more income (Islam 2007). With a potentially stable increase in income, poor borrowers can boost assets, savings, and consumption levels and more successfully regulate fluctuations in lump spending needs—such as education or familial obligations—and economic shocks, such as sudden health-related costs or natural disasters.

Microfinance supporters thus argue that microcredit can "empower" the poor to take control of their economic situation and, with hard work and financial responsibility, lift themselves out of their personal poverty. Through microfinance, the poor are included in global financial systems and markets as rational investors in small business activities. Microcredit recipients are no longer imagined and treated as beneficiaries of development aid, but rather as active participants in their own development as responsible managers of

[3] Singh (1968) reports annualized interest rates up to 159 percent in informal markets in Punjab, India. Siamwalla et al. (1990) find rates from 60 to 120 percent. Aleem (1990) finds rates on average of 70 percent and up to 200 percent; and in contrast, local banks reportedly charged an average of 12 percent annually.

[4] The Baker-Hopkin economic model of credit argues that as long as the return on assets (from the productive investment in an enterprise) is greater than the interest paid, credit will lead to an increase in the income of the household that received the loan (see Armendariz and Murdoch [2005] and Islam [2007]).

credit resources. Donors and investors have cast microcredit in terms of a helpful "hand up" out of poverty as opposed to a charitable (welfare) "hand out" (Yunus 2007; Smith and Thurman 2007). In other words, microfinance has the potential to elevate the dignity and self-esteem of the poor.

A vast amount of literature has emerged to support, and adjudicate, the impact of microcredit in the social and economic lives of women clients (Goetz and Sen Gupta 1994; Ackerly 1995; Rahman 1986; Pitt and Khandker 1995; Hashemi et al 1996; Kabeer 2009; Meenai 2003; Burra, Deshmukh-Ranadive, and Murthy 2005; Rahman 1999; for a discussion on gender and microfinance in Nicaragua, see Nitlapán 2002). Microfinance supporters argue that many women in developing societies lack access to credit services due to constraints such as higher levels of poverty, male guarantor requirements, cultural barriers, low levels of literacy, limited mobility, and legal claims to collateral (Cheston and Kuhn 2002). Through microcredit, a small infusion of cash to establish or expand some sort of economic activity, the female client gains a greater level of control over her household's income and her family's wellbeing. Microcredit supporters claim that microfinance empowers women through its potential to give women greater ownership of resources, economic independence, and a role in household decision-making (Mayoux 1995; GCAP 2010). With access to credit, women gain additional access to financial and business spheres through their participation in public markets. If the women participate in a group lending structure, they may benefit from social networks and support with their peers. Through these benefits, it is argued, women may achieve greater confidence and self-respect. Believing in the power of credit to liberate the poor and especially poor women, Yunus has called for the right to access credit to be treated as a basic human right (Yunus 2010).

Women, the traditional caregivers for the family, are also considered to be more likely than men to use additional income to support the household welfare (Yunus 2007; Elson 1995, Cheston and Kuhn 2002). Arguments have also been made for targeting women on grounds of efficiency and sustainability, as conventional microfinance wisdom has held that women are more cooperative and repay their loans at higher rates than men (Yunus 1994 and 2007; Cheston and Kuhn 2002). As participants in microcredit, women are presented as contributors to and agents in local development processes.

In addition to the potential to reduce household poverty, microfinance advocates argue that investment in microfinance and the microenterprise sectors can contribute to bottoms-up economic development in local communities. The idea resonates with well-known Peruvian thinker Hernando de Soto's theory that the informal sector in Latin America would provide the critical foundation for sustainable economic development in the region (1989). Robinson (2001) suggests that microfinance can create hubs of microenterprise activity, and micro-business growth can lead to a local community's rise out of poverty. The increase in productive activity at the "micro," and often informal, level can stimulate greater local purchasing and selling of materials and products; introduce new, relatively cheap goods in local and national supply chains; and positively influence the wage rate in labor markets (see Bateman's [2010] analysis). Moreover, self-employment of the poor in small-scale productive activities can alleviate the local economic pressure of high formal unemployment rates. With the help of microfinance, the theory suggests, a flourishing microenterprise sector may form the basis of a developing economy and lead to long-term economic growth (Robinson 2001; also see discussion in Dichter 2007 and Bateman 2010).

SECOND-GENERATION MICROFINANCE: SUSTAINABILITY TO COMMERCIALIZATION

By the end of the 1980s, the budding microfinance sector was forced to deal with the question of ongoing subsidies to sustain microcredit operations. Most early MFIs established following the Grameen Bank were structured as non-profit NGOs and were initially capitalized with external donor support. Although high repayment rates suggested potential for long-term financial viability, after years of operation, it became clear that many MFIs were dependent on regular injections of subsidized capital—government or private donations or low-interest loans from development banks—to cover the costs of operations (Armendariz and Morduch 2005). Reports on the Grameen Bank suggested that Yunus inflated his claims of near perfect repayment rates, and exposed the famous MFI's continued reliance on government and private donor subsidy (Morduch 1999). Microcredit, it turned out, was not quite the self-sustaining or financially viable approach to poverty reduction as the international donor community had originally hoped.

On the subsidy debate, microfinance faced an ideological schism (Morduch 2009). Many microfinance practitioners justified the need for continued donor subsidy based on their mission to improve the lives of the poor (Bateman 2010). The *poverty lending approach*, exemplified by the Grameen Bank in its earliest form, emphasizes the end goal of microfinance as the reduction of poverty and empowerment of the poor and views subsidy as necessary to achieve that goal. Others, though, reject the idea of dependency on subsidies and, rather, position the end goal of microfinance as the provision of *sustainable* financial services to poor and non-poor borrowers, formally called the *financial systems approach*.

In order to achieve sustainable institutions, financial systems microfinance takes on a market-oriented, for-profit business-like structure to its credit programs. MFIs

expand the scale of lending, increase the volume of loans disbursed per borrower, increase rates and fees, and tighten repayment discipline by enforcing punitive strategies (Kalpana 2005). Most significantly, under this approach, microcredit interests and fees are determined by the market and must reflect the full administrative, recovery and expansion costs of the loan. Recuperated client repayments plus interests and fees cover all of the operational costs of the institution. Financially sustainable institutions, experts reasoned, would lead to improved (or at least more efficient) financial services to the poor and would potentially lead to exponential growth to serve more and more poor clients (Christen and Drake 2002). Importantly, the success of sustainable microfinance is judged overwhelmingly, if not solely, on the basis of the financial self-sustainability of the institution and not on the impact on the client's economic situation.

Those who promote the "financial systems" approach to microfinance readily embraced the idea of the *commercialization* of microfinance institutions. The commercialization of microfinance generally includes the transformation of non-profit MFIs into for-profit, regulated financial institutions. The heart of commercialization is its focus on profitability and therefore financial stability and viability. For a MFI, having regulated commercial status translates to greater opportunity to attract outside investments from commercial lenders as well as public funding and, importantly, often affords the legal option to capture consumer savings deposits (Drake and Rhyne 2002). Those who argue that microfinance ought to move in the direction of commercialization suggest that the transformation is a critical step to provision of high quality professional services to the poor. Commercialized institutions, now in competition with one another in the market and under the pressure to scale services, would be forced to create innovative, client-centered products in order to retain and gain new clients (Christen and Drake

2002). The trend toward the commercialization of microfinance reflects the commitment to a market approach to microfinance and the goals of efficiency and sustainability.

In the late 1980s, USAID began to support the "second-generation" microfinance focused on the financial sustainability of institutions. Soon afterward, the World Bank began to provide significant technical advice and financial support for microfinance programs. In 1995, the World Bank established the Consultative Group to Assist the Poorest (CGAP; later changed from "Poorest" to "Poor"), a multi-donor institution dedicated to the promotion of the sustainable microfinance. The MicroCredit Summit Campaign, launched in the mid-1990s, solidified the idea of financially sustainable, commercial microfinance as the mainstream microfinance model (Bateman 2010). First-world for-profit investors began to take interest in the commercial microfinance model as not only a way to help the poor and reduce poverty, but as a smart and profitable investment (see, for example, Smith and Thurman 2007).

In 1992, Bolivia's PRODEM was the first institution to transform from a non-profit NGO, established with support from USAID and other private sector funding, into a fully state-regulated commercial bank, BancoSol (Rhyne [2001 and 2002] documents the transformation and rise of BancoSol). As a regulated microcredit entity, BancoSol quickly became the most profitable bank in Bolivia. Advocates of microfinance commercialization hailed BancoSol's apparent success as evidence that microfinance in fact translates into a highly lucrative business model (Christen and Drake 2002). In 1997, BancoSol issued dividends to its shareholders—a first in microfinance history. Throughout the 1990s, the BancoSol example fostered interest in replicating its NGO transformation model.

By the mid-1990s, microfinance supporters promoted the financial systems and commercialization models of microfinance as industry "best practices" (Bateman 2010).

As the international development community and microfinance practitioners focused on ways to best create sustainable microfinance, the early poverty reduction models quietly fell to the wayside and out of the mainstream. The commercialization of microfinance was embraced by industry leaders and sought after as its prime objective (Christen and Drake 2002). As development expert Bateman argues, "'New wave' [commercialized] microfinance was now *the* definition of microfinance, not just one of a number of possibilities" (2010:19, emphasis in original).

The transformation from a non-profit to a regulated MFI, however, is complicated and expensive. To gain status as a regulated institution requires that there are capable institutions and procedures in place in a given country to regulate and supervise the transformed institutions. In many countries, this regulatory framework does not exist, or MFIs cannot easily be incorporated into the existing framework. Many MFIs have maintained their status as non-profit NGOs, but industry experts and external donors and investors have insisted on policy and programmatic changes, primarily by establishing market-based interest rates, to bring MFIs in line with a commercial approach.

In 2001, under external pressures to conform to these new "mainstream" principles, the Grameen Bank transformed its microlending model into the Grameen II project. Although Yunus has always argued to keep interest rates as low as possible in order to give more opportunity to the poor to experience significant change, Grameen II implemented measures to raise interest rates to near market rates. The new model also required borrowers to deposit a portion of their loan into Grameen savings accounts. In the first three years of the Grameen II project, the Grameen Bank's net profits increased six-fold (Islam 2007). The new Grameen model broke from its original methods, and the result was a highly profitable microfinance operation.

CRITIQUES OF MICROFINANCE

More recently, scholars, development experts, and even microfinance practitioners have expressed their concerns with the practical, theoretical and ideological underpinnings of the mainstream microfinance model and have challenged the central claims of its economic impact on poor households and local poverty reduction (for example, Adams and von Pischke 1992; Hulme and Mosley 1996; Kalpana 2005; Dichter 2006; Ellerman 2007; Bateman 2010; Rosenberg 2010). Critics raise critical questions about microfinance and its assumptions and warn about the potential harm from the overinflated hype around the sector. In this section, I highlight a few of the critiques of the microfinance model.

Scholars, industry experts, and microfinance practitioners have noted the absence of robust quantitative or qualitative research on the socioeconomic impact of microcredit on clients (Armendariz and Murdoch 2005; Goldberg 2005; Bateman 2010; Meyer 2007; Rosenberg 2010). Previous attempts to measure microcredit results failed to use controls and exclude all other possible factors in the interpretation of results (Ellerman 2007; Meyer 2007; Gulli 1998; Armendariz and Murdoch 2005; for a summary of impact studies, see Goldberg 2005). Roodman and Murdoch (2009) recently raised serious doubts about the validity of one of the most often cited impact study that had demonstrated significant increases in socioeconomic benefits for clients. In recent years, a small number of randomized control studies have only demonstrated mixed results in short-term outcomes for household welfare and standard of living (Rosenberg 2010; Bateman 2010). Two of these studies found no improvement in household income or increase in consumption (Banerjee, Duflo, Glennerster and Kinnan 2009 and Karlan and Zinman 2009). The one study that did find improvements in welfare was a study on the impact of savings, not microcredit, for poor clients (Dupas and Robinson 2011).

Rosenberg concludes that "(f)or now, it seems an honest summary of the evidence to say that we simply do not know yet whether microcredit or other forms of microfinance are helping to lift millions out of poverty" (2010:1). In the judgment of Roodman and Morduch, "Strikingly, 30 years into the microfinance movement we have little solid evidence that it improves the lives of clients in measureable ways" (2009:3). Despite decades of excited claims of the benefits of microfinance and hundreds of positive anecdotes, we simply do not know how it impacts the lives of the poor.

Small, short-term, high-interest loans are by nature incompatible with the very socioeconomic vulnerabilities of the poor and the poor working in the informal and small business sectors. The poor do not just have low income, but often irregular and uncertain income, which can make it difficult for them to meet inflexible and regular loan repayment schedules. Moreover, the poor are particularly vulnerable to economic shocks. Even if a microcredit client may experience an increase in income as a result of an ideal microcredit cycle, he or she may not necessarily experience a significant decrease in their overall economic vulnerability (Hulme and Mosley 1996).

The microcredit model relies on the notion that the poor can and will use the microcredit to invest rationally in a business activity, and the loan can be repaid successfully by drawing on increased profits from the business. Microcredit assumes that the rate of return on any micro-activity will be regular and high enough to ensure successful repayment. But not all activities, and particularly activities in the very small business and informal sectors, yield equally positive or consistent results. The injection of credit into a productive activity does not guarantee a successful business outcome (profit) to support loan and interest repayment. Moreover, the microfinance model overlooks the potential for business failure, complete loss of investment, and the consequences that may have on the borrower. Hulme writes, "(N)ot all microdebt produces favorable results,

especially for poor people working in low-return activities in saturated markets that are poorly developed and where environmental and economic shock are common" (2007:19).

Several studies have shown that microcredit loan monies are commonly not used for investment, but rather for lump spending needs, emergencies, and basic consumption (Rutherford 2000; Dichter 2007). In such cases, there is no expected financial return and no greater earned profit from a business activity to repay the loan with interest. To repay their loans, microcredit clients may be forced into taking out another loan or selling household goods, which in turn may lead them into deeper poverty than before they accessed their microloan.

Is credit what the poor want? The microcredit literature often assumes that there is an unmet demand for credit services among current clients and millions of other poor not yet served by microfinance (see for example, Robinson 2001). Allen (2007) argues that the poor, by nature of their economic vulnerability, are especially risk adverse. Several studies have shown that many and in some cases a majority of poor individuals choose not to take out a microloan, often either because they did not have the need or because they did not want the debt (Navajas and Tejerina 2006; Magill and Meyer 2005; Johnston and Morduch 2007). In an enlightening study, Rutherford (2000) suggests that the poor express a need and desire for reliable, secure savings as a means to regulate income and spending needs. Poor households save money, often in their homes or through informal savings deposit collectors or associations (Rutherford 2000). Historically, microfinance institutions have focused primarily on credit services, and microsavings—as a part of microfinance services—is still largely unavailable to most microcredit clients and the poor (Hulme 2007).

Is microcredit "empowering" the poor and, in particular, poor women? A large number of studies seem to indicate that microfinance can have a positive impact on the

personal, social, and economic empowerment of its clients (Schuler, Hashemi, and Riley 1997; Todd 1996; Burra, Deshmukh-Ranadive, and Murthy 2005). However, other studies, particularly those that take into account clients who exited a lending program, also show the real potential for borrowers to experience *disempowerment* as a result of their use of microcredit (Rahman 1999; Karim 2005). The flip side of microcredit might also be looked at as micro-"debt." Dichter (2007) argues that this switch in language allows for a deeper discussion on the range of experiences for clients of microfinance and calls attention to the potential burden of credit. Borrowers who struggle to make use of their loan to generate income and who enter into default may spiral into further debt through late fees, sacrifice family needs or sell assets to be able to repay, or lose property to asset seizures. The borrowers may also face sociological effects related to harassment, peer pressure, shame and a loss of social status. In an extreme case, a number of borrowers in Andhra Pradesh, India reportedly committed suicide over their microdebts with MFIs accused of exercising usurious interest rates and excessive loan recovery practices (Shylendra 2006; The Economist 2010).

As discussed above, a great number of studies suggest that in certain cases, women may benefit economically, psychologically and socially from their involvement in microfinance. Impact evaluations of a female client's self-esteem, role in household decision-making, and increase in knowledge are complicated, and results from client studies have been mixed (Fouillet and Palier 2005). Not all women experience positive outcomes, and an increasing number of studies caution about the negative experiences women in particular may face as borrowers of microcredit (see Guerin and Palier 2005). Some studies of women's access to and use of microcredit have revealed cases in which women lose control of credit monies to their male partners and suffer greater domestic

violence or face negative social pressure from other women in borrower groups (Goetz and Sen Gupta 1996; Rahman 1999).

Moreover, scholars warn that the targeting of women by microfinance runs the risk of essentializing women and their gender roles (Rankin 2001). Women are the special targets of microfinance because of their very economic and social vulnerability and unequal position in social hierarchies. As Rankin writes, "(T)he new agents of development are gendered as women entrepreneurs with cultural propensities to invest wisely and look after their families and communities" (2001:20). It is these same characteristics—wisdom and responsibilities—that make a woman more likely to repay her loan (Kabeer 1994). Deshmukh-Ramadive broadly defines empowerment as "a process that takes place when inequalities move toward equality" (2005:114). However, microfinance may place greater burdens on already disenfranchised women by placing the responsibility for development on their shoulders (Rankin 2001).

Through microfinance, poor borrowers are invited to participate in development, but only in terms of their consumption of credit. Most typically, they are not able to participate in the decision-making within microfinance institutions, state politics, or regional or global development agencies (Rankin 2001; Devi 2005; Sundaraarajan 2005). As Mohanty (2001) suggests, microfinance supporters often use the term "empowerment" in a way that implies that an outside agent (the lending institution) grants power to the poor. This, however, does not constitute a real redistribution of power. Moreover, Mohanty argues, the poor are encouraged to exercise power over their lives, but only to do so without disrupting greater power structures. Microfinance may do little to challenge larger structural and social inequalities that the poor, and especially poor women, continue to face (Guerin and Palier 2005). For instance, the use of microfinance does not directly affect hierarchical, patriarchal relationships and structures

within households and communities (Deshmukh-Ramadive 2005; Thampi 2005). At worst it may exacerbate exiting inequalities and contribute to the prevailing system of economic domination (Rankin 2001; Kalpana 2005).

The new wave of interest in the commercialization of microfinance has introduced new challenges within the global microfinance sector. Some practitioners reject the requirements of commercialization and its emphasis on return and expansion as a drift away from the original mission of microfinance (for example, Wilson 2007). Under the pressure to scale up to achieve financial stability, MFIs must lend more by incorporating more and more clients and making bigger loans. This has led MFIs to transition to a client base of those at or above the poverty line and the non-poor. In one argument, these larger loans to the non-poor help the MFI to subsidize the many small loans to the poor (Armendariz and Szafarz 2009). From another perspective, this may mean that an MFI may slowly drop its poorer clients for the sake of financial gain (Christen and Drake 2002).

Once microfinance institutions commit to operating on a commercial rather than a poverty-lending basis, the market environment fosters increased competition (Christen and Drake 2002). In theory, competition will lead to client-centered changes in loan product design, pricing, or delivery mechanisms to order to retain and gain clients (Rosenberg, Gonzalez and Narain 2009). However, in effort to expand rapidly in increasingly saturated markets, MFIs may turn to questionable practices. In 2006, a crisis in Andhra Pradesh raised critical questions about the eager growth of microfinance and its repercussions. As Ghate (2007) explains, the rush to expand services in one of the region's most saturated microfinance market, led to a neglect of client-focused practices. MFIs in Andhra Pradesh had deceived clients on interest rates, fees, and terms of the loans; turned to coercive collection practices; and over-lent to over-indebted clients. The

national press reported on a number of suicides of borrowers who were indebted and faced abusive collection pressures. The local government intervened and temporarily closed almost all of the MFI branches in the region. The case is complex and beyond the scope of this thesis; however, it points to the potential dangers of excessive growth and hypercompetition in microfinance markets.

In 2007, the transformation of Compartamos, the largest microfinance institution in Mexico, to a regulated commercial entity ultimately challenged the overwhelming drive to the commercialization of microfinance. Microfinance supporters had rallied behind the commercialization of Compartamos and hailed it as the next example of successful commercial microfinance. However, the transformation process revealed the MFI's gross practices and incredible profits. While charging high interest rates—up to 100 percent—to its poor female borrowers, Compartamos executives reaped salaries and bonuses of tens of millions of dollars (Armendariz and Morduch 2005). Yunus publicly rebuked the greed and excess of the Compartamos executives and compared their practices to those of loan sharks. He also warned of the negative fallout of the disaster and referred to the revelation as the end of microfinance (Epstein and Smith 2007). The revelation underscores the concerns with a commercial, market-focused approach to serving the poor. However, despite the Compartamos experience, leaders in the global microfinance industry continue to argue that the path to commercialization is the foremost objective.

The commercialization of microfinance has also created a perhaps unexpected paradox. Commercialization of microfinance has led private commercial banks to expand their lending to poor, rural clients who were traditionally excluded from formal bank credit. Microfinance, after all, has supposedly proven to the financial world that the poor are bankable. Also, private commercial banks have the financial strength, access to

technology, and legal environments that can allow them to overcome the very service and scalability problems with which commercializing MFIs continue to struggle. As Christen and Drake (2002) suggest, it may be the case that traditional commercial banks can provide better, more client-centered microfinance services to the poor than can MFIs.

Does microfinance lead to economic development and poverty reduction? While the premise of microfinance is its potential to foment economic development, in his recent book, Bateman (2010) argues that the dominant microfinance model has not clearly resulted in significant local sustainable poverty reduction or economic development in any developing or transition economy. For example, Ellerman asks, "(I)s Bangladesh [the birthplace of modern microfinance and one of the most saturated markets] on anyone's list of development success stories?" (2007:151). After thirty years of microfinance development, there is little evidence that credit for microentrepreneurs leads to long-term local economic growth and poverty reduction.

Dichter (2007) examines the historical economic development of present-day developed nations and role of credit in small enterprise development, and he finds that there is little connection between widespread access of credit to the poor or small businesses and larger-scale economic growth. Before and during economic development, financing for business start-ups and small businesses in these countries primarily came from self-savings or from informal credit sources, such as loans from family or social networks, and not from formal, institutional credit. Formal credit was reserved for established medium to large-sized businesses. The general use of formalized credit for small business activity was a *result* of economic growth, not a requirement for it.

Moreover, Dichter's historical analysis reveals that the early development of widespread financial services for the poor followed economic development, industrial growth, and job creation, and was based primarily on savings, not credit. The mass use of

credit followed the savings movement and was linked to consumption by the working poor. He concludes that while the microfinance movement has assumed that credit is a precondition for economic development, "history seems to be telling us clearly that economic development and its consequent massive poverty reduction did not depend on microcredit being made more accessible for income production or asset acquisition by the poor" (2007:191).

Ellerman argues that microfinance may serve as a poverty relief program rather than a development assistance intervention. He suggests that microfinance transferred limited resources into the hands of the poor but does not lead to economic development (2007). Bateman (2007 and 2010) is even more critical of the intervention of microfinance as a means to development and poverty reduction. He argues that microfinance may in fact serve as an *anti-development intervention* in developing and transition economies and may harm the potential for significant industrialization, job creation, and sustainable growth.

Microfinance assumes that credit can spur microenterprise development as a means to achieve bottoms-up economic growth. With credit, the poor can start up or invest in some small income-generating activity, most often in the informal market. The informal market is generally the space where one offers the most basic goods and services of a means of survival existence or subsistence living. The low-productive activities many microcredit clients undertake in the informal sectors are those that generate some of the lowest profits and incomes and are highly vulnerable to price fluctuations and competition (Bateman 2010; Malhotra 1992). With increased availability of microcredit for microenterprises, the result may be an over-supply of many similar informal, non-industrial basic income-generating activities. The local economy quickly

becomes saturated with microenterprises in heightened competition, with high risk and vulnerability for failures.

While a microenterprise employs generally one person or household in the informal sector, the investment in microenterprise, however, rarely leads to the creation of new or more formal jobs. There is little evidence that these microactivities eventually evolve into more formal enterprises and stable small to medium-sized businesses with the capacity to create employment opportunities. Bateman concludes that the focus on microcredit for growth and development instead creates infantile informal economies of many self-employed individuals in basic, low-productive activities.

As Bateman argues, the mass investment in microfinance from external development aid agencies, banks, and investors directs valuable resources away from macroeconomic interventions that have greater potential to stimulate more rapid and long-term growth, such as more larger-scale commerce and industry, skilled worker training, and technologies to improve productivity. The attention on microfinance also deters from investment in public projects that assist the poor, such as investment in health, education, and infrastructure. Such infantile local economies create greater import dependency. The introduction of microfinance, Bateman suggests, may in fact halt or slow local chances for sustainable economic growth and progress and thus mass poverty reduction (Bateman 2010).

The numerous and growing challenges to the microfinance model have challenged the overinflated expectations of microfinance's potential outcomes for poverty reduction and development. Dichter and Harper (2007) explain that there has been a certain level of "push back" by the poor, by some large microfinance practitioners who quit their lending programs, and by governments concerned about microfinance practices. At the very least, these critiques begin to open up a broader discussion about the practice and nature of

microfinance and the reality of its impact on the lives of the poor and in the development of economies. In more recent years, some of the excitement over microfinance may have waned, but there is little evidence that microfinance practices and the larger development trends that support it will change dramatically in the near future.

Chapter 2: Conceptual Framework: Microfinance as Discourse

> The most accurate location for the microfinance model is within the most fundamentalist and anti-poor variant of capitalism: neoliberalism.
>
> Milton Bateman, *Why Microfinance Doesn't Work: the Destructive Rise of Local Neoliberalism* (2010:165)

The idea of microfinance emerged as development experts and policy makers began to turn their attention away from macroeconomic development projects and from external donor or state-led models of rural and poverty finance. In the mid-twentieth century, many developing countries created large state-controlled rural development and agricultural finance programs to support rural productive and agricultural sectors (Adams and von Pischke 1992). These finance programs provided government- or international donor-funded subsidized credit to producers and small farmers in efforts to increase productive activity and implement new technologies (Dichter 2007; Armendariz and Morduch 2005). Increasing productivity, it was argued, would increase labor demand and wages and stimulate the rural and national economy.

However, first-world development practitioners and donors eventually discredited state-led financing models for development for reported inefficiency, low recovery rates, clientelism, corruption, and the perpetuation of dependency on subsidy (Adams, Graham, and von Pischke 1984; Adams and von Pischke 1992; Rankin and Shakya 2007; Armendariz and Morduch 2005). Following the critique of state development models and early agricultural credit programs, the World Bank noted that "new means of structuring relationships with the poor are required" (von Pischke, Bennet, and Goldberg 1993:5). Microfinance, as a private, market-based approach to poverty reduction, appeared to be a

promising alternative development model. Microfinance promised to replace the onerous state and its inefficient state banks and to deliver more credit to target groups while reducing costs and expanding benefits (Armendariz and Morduch 2005). By the end of the 1980s, increasing international interest elevated microfinance to become the prevailing economic development initiative for third world countries.

Weber argues that the idea that microfinance is an effective intervention for poverty alleviation holds the status of a hegemonic discourse (2002 and 2004). Here I define discourse as historically situated, structured forms and patterns of knowledge that construct and constrain possible meanings and shape social reality and subjects. Discourses are not just expressions of social practice, and discourse is located not only in language but also in institutions, practices, and social relations (Wodak and Meyer 2009). Discourse guides individual and collective creation of reality, Jager and Maier (2009) argue, by creating subjects as co-producers and co-agents of discourses. As Jager and Maier explain, "(D)iscourses exert power because they transport knowledge on which collective and individual knowledge feeds. This knowledge is the basis for individual and collective, discursive and non-discursive action, which in turn shapes reality" (2009:39). Dominant discourse produces and reproduces social domination and the abuse of one group over another. Moreover, as Wodak and Meyer (2009) argue, discourse shapes how dominated groups may resist the abuses of power. In this chapter, I explore the nature of microfinance as a discourse through the dominant narratives it produces and reproduces, the privileged rationality (ways of knowing) it emphasizes, the underlying economic system to which it is tied, and the subjectivities it forms.

Microfinance advocates have consistently celebrated the positive results of microcredit programs and constructed a hugely optimistic narrative around the microfinance model. High repayment rates are often cited as decisive evidence of a

successfully completed loan, and the increase in the number of clients and loans made are noted as proof of borrower demand and need for these microcredit services. MFIs and microfinance supporters report countless individual stories of poor entrepreneurial clients who creatively invested their loans and realized a positive impact in their lives (see for example, Yunus 1994; Counts 2008; McLeod Arnopoulos 2010; Bornstein 1997; IADB 2006; ACCION 2010).

Industry practitioners and supporters have generally made blanket presumptive claims that microfinance will result in positive outcomes for its client borrowers and their communities. The United Nations declared 2005 the International Year of Microcredit with a statement reading, "Microcredit has been changing people's lives and revitalizing communities since the beginning of the trade. Currently microentrepreneurs use loans as small as $100 to grow thriving businesses and, in turn, provide [for] their families, leading to strong and flourishing local economies" (International Year of Microcredit 2005). The published report from the State of the Microcredit Summit Campaign claims "microcredit is one of the most powerful tools to address global poverty" (Daley-Harris 2006). Yunus has continually championed the revolutionary promise of microfinance to reduce poverty and famously stated he will create a "poverty museum" after the condition is eradicated (Yunus 2007 and 2010). These types of narratives produced and consumed through the microfinance discourse create hyperinflated expectations about microfinance's potential and its impact.

Underneath microfinance's numerous anecdotal success stories and claims to poverty reduction lay privileged rationalities or ways of knowing. The microfinance discourse feeds on and reproduces values of individualism, entrepreneurialism, and self-help, and underlying assumptions about poverty, markets, and economic development. Microcredit represents a major shift in development rationality—from a view that the

state is responsible for providing financial capital and economic opportunity to the poor and marginalized to one in which credit delivery is best placed in the hands of local specialized private institutions, and rational individuals are responsible for securing their own economic welfare (Bateman 2010; Rankin 2001; Rankin and Shakya 2007). In this understanding, the poor individual is the central actor and responsible party in the solution to the problem of poverty. Moreover, the individual's successful participation in the market, and the eventual accumulation of wealth, are held as the primary indicators for overall economic development. Microfinance emphasizes individual entrepreneurship in the private market as the means to poverty reduction, wealth accumulation, and economic development over all other possible forms, such as state-led development, welfare spending, wealth redistribution, or cooperative models (Ellerman 2007; Bateman 2010). Within this limited individualistic view of poverty and development, greater structural causes of poverty and structural change are essentially ignored.

Microfinance functions within a certain set of economic institutions and structures. Specifically, microfinance emerged to become the favored development intervention as neoliberal capitalism solidifies its position as the globally dominant political economic system. Rankin and Shakya (2007) argue that the basic tenets of neoliberalism—particularly the idea that markets are the best mechanism to achieve growth and efficiency—are reflected within microfinance. Mainstream microfinance is grounded in the ideas of participation in markets, minimalist states and deregulated institutions, and the self-reliance and resilience of individual households. To understand how these connections play out through microfinance and on the ground, Rankin and Shakya (2007) insist that neoliberalism must be treated as a hegemonic process by which legitimacy is expressed within prevailing political and cultural discourses, both in global terms and within the policies, institutions, and social structures of national contexts.

Rankin rejects the representation of neoliberalism as "the natural and inevitable outcome of unleashed market forces" (2001:22). Instead, neoliberalism and its related projects become the established system of rule through contested processes in national political and moral domains. It is through this hegemonic process that states legitimate the liberal market rationale among their citizens and create systems and policies to ensure its functioning.

Weber (2002 and 2004) argues that microcredit has been "strategically embedded" in the global political economy as a means to legitimate and facilitate global neoliberal restructuring. The World Bank has played a major role in facilitating the "enabling environment" for financial liberalization and adjustment, and has done so via microcredit and its poverty reduction agenda. Weber suggests that it became clear that the Washington Consensus's structural adjustments were limited in their promise for social justice, and there was an increasing potential for resistance to political reforms. Thus the post-Washington Consensus then "was challenged to respond to calls for 'adjustment with a human face'" (Weber 2002:538). In this context, the World Bank developed a distinct poverty agenda, targeting NGOs, poverty programs, women's programs, and microenterprises, and tying debt relief programs with the implementation of targeted poverty programs. Through this process, Weber argues, microcredit was repositioned as a poverty alleviation component of structural reform (Weber 2002). As a product of this agenda, in the mid-1990s, the World Bank formed CGAP, a multi-donor initiative with the mandate to facilitate an environment that enabled microcredit. Weber explains that CGAP coordinates with the World Bank to achieve regional and country-level commitments for financial liberalization.

The political and social power of microcredit relies on its production of particular forms of subjectivity (Rankin 2001). The "subjects" of the development intervention

(microcredit) are no longer beneficiaries with social rights to welfare, but rather rational clients with responsibilities to themselves, their families, and the community. The ideology of microcredit espouses a social identity—the hard-working, self-reliant, profit-maximizing entrepreneur. The individual client is responsible for smartly investing his or her loan in a way to seek profit, enhance the family's income and standard of living, and ensure successful repayment. The client is constructed as the principal agent in the family's escape from poverty as well as an ally of local economic development. His or her repayment of a loan plus interest contributes to the ongoing sustainability of the lending institution and therefore the economic opportunity and welfare of himself and the entire community. Here, the burden for development and poverty alleviation falls on the shoulders of the poor and disadvantaged (Bateman 2010; Rankin 2001). Not only are the poor expected to work their way out of their own personal situation of poverty, they are increasingly expected to pay the full costs of their exit (Bateman 2010).

Rankin (2001) argues that this subject identity shaped by the microfinance discourse functions as a means to legitimate the market rationale and restructure the relationship of individual citizens to the state. In one interpretation, microcredit is a form of subjugation as it attempts to create individual subject-clients that fall in line with the prevailing political and economic rationalities (Rankin 2001). The subjects are thus understood as pawns in a larger, and perhaps a sinister, neoliberal project, and individuals are stripped of their potential to act as agents who contest and resist these subjectivities.

Bateman (2010) and Weber (2004) suggest that the promotion of microcredit as a social remedy to poverty has functioned in a way that deflects citizens' demands on the state and dampens any resistance or challenges to the ruling social order. Bateman writes that "(m)icrofinance delegitimizes and helps dismantle all possible 'bottoms-up' attempts to propose alternative development policies that might be of direct benefit to the

majority" (2010:161). For Bateman, microfinance serves as a means to "contain" the poor. Though the microfinance discourse, Bateman suggests, the poor frame their exit from poverty through their personal interaction with the market, not through social movements, organization in union, or political pressure for more radical remedies such as land reform or wealth redistribution. Similarly, Weber (2004) argues that microfinance serves a political safety net by creating opportunities to empower the poor by engaging them in micro-entrepreneurial activities. The motivation, she argues, "is to use microcredit intervention as a means to pre-emptively counter social protest or political dissent by using credit to off-set income insecurity…" (Weber 2004:362).

These scholars seem to describe a situation in which the microfinance discourse has created a reality where the subjects (the borrowers) do not and are not able to resist. This interpretation, however, ignores the documented ways that clients have challenged and undermined microcredit goals; the ways local cultural politics interact with and contest microcredit rhetoric and ideology; and the ways that microcredit has led to social change in surprising and unintended outcomes (for example, Kabeer 1994; Sen 1990; Rahman 1999). The problem with this perspective is that it constructs microfinance clients as objects of microfinance and ignores the possibility of client agency. As I explore in the subsequent chapters, microfinance clients in Nicaragua are actively resisting the prevailing microfinance discourse, creating new narratives and subjectivities, and opening up a new space of public debate. In the conclusion, I reflect on the significance of their resistance for microfinance in Nicaragua and in general.

Chapter 3: History of Economic Development in Nicaragua up to the Age of Microfinance

Microcredit as a development intervention has a relatively recent history in Nicaragua. Microfinance emerged in the early 1990s as the country underwent a jarring shift from a development approach in which the revolutionary nation-state assumed the responsibility for socioeconomic welfare to one in which that responsibility is placed in the capitalist market. This particular history, marked by the implementation of structural adjustment political and economic reforms, created new ideological and structural spaces where microfinance, as a private non-governmental effort to serve financially excluded microentrepreneurs and the rural poor, took hold.

Revolutionary Sandinistas and Credit, "Sandinista-Style"

When the Sandinista revolutionaries ousted the brutal, four-decade-long Somoza family dictatorship in 1979, they inherited an economy devastated by corruption, war, and a highly inequitable economic structure. On the heels of the revolution, the Sandinista leadership attempted to break with the exploitative, socially regressive agro-export economic model fostered by the Somoza dictatorship and instead establish a state-led redistributive economy (Booth, Wade, and Walker 2006; Babb 1995). The Sandinista government seized and redistributed the estates of the Somozas and their friends, nationalized select private industries, established social services and labor policies to support the poor, and distributed resources to the country's small-scale, low-wealth producers (Booth, Wade, and Walker 2006).

The seized lands were transformed into state-run farms and rented to state-sponsored peasant cooperatives, or in some cases, lands were granted a few individuals for small-scale production (Colburn 1986). As a critical part of the restructuring of the national economy, the Sandinistas moved quickly to restore and stimulate the agricultural sector—the backbone of the Nicaraguan economy—and revive domestic and export production. The government bought and sold products from rural small-scale producers, underwrote some costs of production supplies, and established import controls and tariffs to protect domestic markets (Colburn 1986). In the first four years of the revolutionary state, agricultural production experienced a growth in output and returned to pre-revolutionary levels (Colburn 1986).

Babb (1995) describes how the Sandinista government reorganized work and labor in the urban centers and the countryside. The government encouraged formal employment, created thousands of formal wage positions, and attracted workers to the expanding state sector in the cities and on state farms. Workers in small-scale activities and the informal sector were encouraged to organize in collectives, and through the cooperatives, the state provided access to training programs, credit, and low-cost products, and bought and sold the products they produced (Babb 1995). The labor reforms were established to address the problems of unemployment and underemployment, to protect workers and maintain wages, and to encourage small-scale productive activities.

The new government nationalized private industries and brought them under state control. The Sandinista leadership nationalized private domestic banks, which, during the Somoza era, had developed in a mutually beneficial relationship with the agro-export industry and landed elite and concentrated resources among the wealthiest large-scale producers. The traditional private banking system historically excluded small-scale, rural

producers and small-scale businesses. The Sandinistas consolidated the financial system under the national bank, and its development operations, BANADES, offered small-scale rural producers access to state credit programs. Sandinista economists referred to 1980 as the year of the *piñata*, as the state generously scattered credit around the countryside and into the hands of the rural poor: new bank branches opened in rural towns and mobile banks delivered credit resources to more remote areas (Enriquez and Spalding 1987). The national banking system was reorganized under efforts to undo the concentration of resources at the top and make them available to those who had been excluded by the traditional financial system. For the first time, formal credit was available to thousands of rural producers.

The government encouraged the organization of rural producers in agricultural cooperatives to facilitate the disbursement of credit. By loaning to cooperatives—some organized specifically for the solicitation of credit—BANADES could distribute financial resources to a larger number of producers with fewer administrative costs of managing many individual applications and borrowers. BANADES' programs offered rural producers favorable credit, dispensed in cash, with special interest rates of 11 to 13 percent for individual borrowers and 7 to 8 percent for cooperatives (standard interest rates for larger producers were 17 percent) with minimal, if any, collateral (Jonakin and Enriquez 1999). The number of rural producers receiving credit nearly quadrupled from 28,000 at its pre-revolutionary peak in 1978 to 100,000 in 1980, and the amount of credit directed toward small-scale producers increased by 600 percent (Colburn 1986).

However, the Sandinista government's rural credit programs ran into several problems. In keeping lending interest rates low for borrowers, real interest rates (taking inflation into account) were low and often negative and undermined savings deposits. Over-generous credit delivery (possibly exceeding producer need), the state control of

food prices to support urban populations, and the spread of the Contra war complicated small producers' abilities to repay (Jonakin and Enriquez 1999). In 1980, the repayment rate was 26 percent and that figure only rose to 50 to 60 percent by the mid-1980s. In 1982, the government contracted its program and reduced the number of loans it made to the rural production sector. The following two years, the government enacted selective debt pardoning targeted to small producers of basic food crops and assumed the debts of the state farms. With low recovery rates and rising inflation discouraging savings deposits, BANADES operated at a loss and relied on the government to underwrite its low-interest loans (Enriquez and Spalding 1987; Jonakin and Enriquez 1999). Nonetheless, throughout the decade, the state served as the primary provider of low-interest credit for rural producers.

THE TRANSITION TO A CAPITALIST MODEL AND CREDIT, "NEOLIBERAL STYLE"

Enduring national economic hardship, the U.S.-backed Contra war, and economic embargo, the Sandinistas struggled to control the downward economic spiral and its effects on the population. At the end of the decade, Nicaraguans went to the polls and replaced the Sandinista government. The National Opposition Union (UNO) party, headed by Violeta Chamorro, quickly embraced the mandates of the International Monetary Fund (IMF) and, with the help of USAID, initiated the process of structural adjustment and austere economic and social reforms. The transition from socialist-oriented models to capitalist, market-driven models was not simple, but rather, as Babb (1995) suggests, "negotiated processes that often allowed for unexpected economic juxtapositions." In fact, market liberalization and adjustment measures were undertaken by the Sandinista regime in 1988 to control hyperinflation, and into the early 1990s, the

state also played a role, though now much more limited, in regulating markets. Nonetheless, since the adoption of a neoliberal agenda, the Nicaraguan government has overseen a "systematic undoing" of the economic reforms implemented by the Sandinistas (Babb 1995).

The neoliberal adjustment required steep cuts to government spending, the dismantling of the state sector and reestablishment of private industry, and the institution of policies that favored an open market and profit-led economy. As historian Walker (1997) argues, "All these, it was believed, would eliminate inflation, increase productivity, stimulate international trade, and result in economic growth. Although many people would be dislocated and suffer in the short run, long-term economic growth would eventually be to the benefit of all." The government's support of a market-led, competitive structure favored foreign investment and large-scale producers and industries to the detriment of the country's poor.

In an effort to stimulate the economy, the Chamorro administration removed poor-protective policies and aggressively redirected policies and resources to support an agro-industrial export and open import economic strategy. In the competitive market, high-wealth, large-scale businesses, both national and international and new, cheap imported goods effectively drove smaller industries out of business. Small-scale producers and cooperatives, no longer assisted by the state, failed at increasing rates (Babb 1995). Unable to access resources and compete in the new market, small producers sold their lands or simply abandoned rural production and entered the wage and informal markets for employment (Jonakin and Enriquez 1999; Babb 1995). Jonakin and Enriquez (1999) illustrate the trend throughout the early and mid-1990s in which small-scale farmers sold land, often at distress sale rates below market value, to mostly wealthy,

large-scale producers, resulting in increasingly concentrated and unequal distribution of land.

Economic and labor reforms also had detrimental effects on smaller-scale businesses. *Barricada Internacional* reported on a CONAPI study that showed around 7,000 small and medium-sized industries and services closed in 1992, which left just some 3,000 shops registered with the Ministry of the Economy (Babb 1995). Babb (1995) examines the political, economic, and discursive shift to marginalize cooperatives promoted by the Sandinistas and to endorse microenterprises as emblematic of the free markets in the context of the early 1990s neoliberal agenda. The newly established Office of Small Industries and Microenterprises under the Ministry of the Economy, along with a handful of NGOs, provided loans and technical assistance to promote microenterprise development, and the National Program to Support Microenterprise carried out publicity campaigns and organized fairs to promote the sale of microenterprise products and goods. However, as Babb found in interviews with program directors, many of the supported microenterprises had gone out of business and were unable to repay their loans. The small businesses had little chance of success in an economic climate that favored cheap imported goods and competition. As Babb concludes, "(T)he new administrative apparatus and discourse around microenterprises seems designed to offer hope to the most vulnerable economic sector at the same time that neoliberal policies further undermine the chance of success of that sector" (Babb 1995:6).

Cuts in the state sector meant the loss of thousands of formal wage jobs: the "Occupational Conversion" program, funded by USAID, oversaw the removal of 28,000 state jobs in 1991 (Babb 1995). The government opened "free trade" zones near urban centers and international companies offered some low-wage employment. As small-scale

producers left their lands, small-scale industries failed, and former state employees exited their jobs, the informal sector in urban and rural areas swelled.

The newly reestablished private commercial banking system was proposed as the means to counter the withdrawal of the state and its perceived inefficiency and failures in financial markets. The IMF agreements signed in 1991 required the Central Bank and newly established private financial institutions to conform to financial "efficiency criteria" (Booth, Wade, and Walker 2006). Interest rates would be determined by the market rather than the state, and would reflect costs plus premiums for administration, risk, and inflation. Bank authorities instituted policies that tightened controls and restrictions on lending and required greater security and full repayment of prior loans before additional credit would be released. Commercial banks avoided lending small loans to poor borrowers with limited value collateral and vulnerability to economic shocks due to the assumed risks and to the additional administrative and delivery costs of small individual loans. Tightened loan requirements meant that many borrowers, especially those without collateral, were excluded from private bank credit. As loan interest rates had doubled from what they were in the 1980s, many clients were priced out of the market. Commercial bank credit became markedly concentrated: 72 percent of private bank credit resources were disbursed among 6 percent of their clients—just 880 individuals—who received larger loans of C$250,000 or more (Jonakin and Enriquez 1999). The total loan portfolio of private banking system directed to agriculture and livestock was just 26 percent, and most credit was concentrated in commercial, industrial, or personal credit. Moreover, any severely limited lending to the rural production sector in the 1990s was undermined by the larger economic policies that supported large-scale business, facilitated mass agricultural export, and opened the domestic economy to the "free" market competition of foreign exchange (Babb 1995). As Jonakin and Enriquez

(1999) suggest, the reconstitution of the private financial markets only renewed the problem of systematic market failures and exclusion of the rural and small-scale production sectors.

Under neoliberal economic reform, the eventual dismemberment of state credit programs left small-scale producers without access to credit. Immediate cuts in spending at the Banco Central meant sharp retraction in BANADES and Banco de Crédito Popular credit programs. Restrictions on the disbursal of credit to those defaulted, the establishment of market interest rates (at 30 percent for BANADES in 1994), and the closure of rural branches effectively excluded many rural producers and poor borrowers. After 1991, the area (*manzana*) financed and agricultural credit disbursed dropped by 50 percent for the 1992 harvest cycle and continued an overall downward trend until 1998 (Jonakin and Enriquez 1999). Significantly, several strong indicators show a reversal of the trend of credit for the country's low-wealth, small-scale producers and illustrate a concentration in credit available to fewer wealthy borrowers. Crops for domestic consumption—beans and corn—faced the greatest cuts in credit as compared to crops for export. The share of BANADES financing for large-scale producers rose from 31 percent to 71 percent, and the number of client-borrowers decreased from an average of 80,000 in the 1980s to just 13,580 in 1992. In 1993, a report by the Superintendency noted that 124 BANADES clients held loans over an average C$2.5 million (Jonakin and Enriquez 1999). Though in 1993 the IMF and World Bank rhetorically encouraged BANADES to redirect its lending priorities to rural producers, the economic reforms undermined BANADES's ability to do so (Jonakin and Enriquez 1999). In 1994, under new IMF agreements, BANADES credit was cut further. By 1996, 14,000 producers defaulted on BANADES loans and faced foreclosures on the lands (Jonakin and Enriquez 1999).

At the end of the decade, under pressure from the World Bank and IMF and the new reform agreements, the Nicaraguan government ceded to neoliberal rationality and closed BANADES. In its place, though, the National Assembly created the Fund for Rural Credit to act as an intermediary, receiving funds from the Nicaragua Investment Finance Corporation (FNI) and loans from external bi- and multilateral organizations and disbursing loans to financial institutions, banks, and MFIs (*Ley 294*, 1998). The government also began the private sale of its shares of the Banco de Crédito Popular, and the state-led institution was eventually dismantled.

The state was eventually removed as a provider of credit. Rather, in its new form, the state served as a gateway to funnel external loans from international development agencies and development banks into the country's expanding private microcredit sector. As the first decade of structural adjustment and reforms closed, Nicaragua was one of the poorest and most aid-dependent countries in Latin America. In the early 1990s, GDP growth was negative or flat, and only increased slightly in the mid-1990s. The overall economic growth was particularly sensitive and vulnerable to global price changes in commodities, especially coffee. Overall poverty in Nicaragua in the 1990s remained around 50 percent and extreme poverty averaged 18 percent, but rural poverty was at 68 percent and 29 percent in 1998 (World Bank 2003). With the growth in population, there were 180,000 more people in poverty by 1998 (World Bank 2003). Unemployment was high: official rates were reported to be around 25 percent, but independent reports suggest unemployment was as high as 60 percent in 1995 (Jonakin and Enriquez 1999; Babb 1995). Social indicators—health, nutrition, education, literacy—and basic infrastructure—clean water, sanitation, electricity, and housing—were at best stagnant throughout the decade (World Bank 2003). The economic and social problems were

exacerbated and put in sharp relief in 1998 in the wake of the destruction of Hurricane Mitch, one of the worst natural disasters in the country's history.

Ultimately, increased competition driven by the market-oriented approach to development, along with the sudden lack of access to credit and protective policies, pushed the poor to abandon small businesses, sell properties, and move into low-wage labor and informal activities. Wealth, land, and resources were increasingly concentrated in the hands of the wealthy and powerful. The political-economic transformation prioritized private, liberal markets as a means to economic stability and development. Under these transitions, the foundation was laid for the emergence of microfinance in Nicaragua, which I review in the next chapter.

Chapter 4: Modern Microfinance in Nicaragua

In the early 1990s, following changes in the economic structure resulting from structural adjustment reforms, a number of NGOs emerged with non-traditional financial programs and the vision of reaching low-wealth borrowers excluded from traditional commercial credit and abandoned by the withdrawal of the state credit.[5] The evolution of these microcredit programs and institutions took place as the state delegated the responsibility for development and poverty alleviation to the private sector and individual actors. Over the next two decades, these NGO microlending programs have come to play the most significant role in the provision of small-scale credit to Nicaragua's rural producers, small businesses, and urban poor.

In the first three years of the neoliberal agenda, many micro lending programs were created through well-established international microfinance agencies (such as

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[5] It is important to note that non-state "micro" loans to rural farmers and small businesses did not begin in Nicaragua only after the transition to a neoliberal model. Prior to 1979, a small non-traditional credit market provided savings and credit services to small- and medium-scale producers and retail businesses in Nicaragua. Credit and Savings Cooperatives (CACs), under the supervision of the Ministry of Labor, operated as rotating credit and savings associations with member savings acting as the source of funds for loans to its members (Jonakin and Enriquez 1999). While the CACs and other sources of informal credit were the primary credit resources for poorer borrowers before the 1980s, the abundant supply of credit under Sandinista credit programs and high inflation rates drastically undermined the financial role of CACs in the 1980s.

Cooperatives (credit union-like institutions) also played a role in the new credit markets that opened after 1990. Generally, these member-owned institutions, regulated by the Ministry of Industry and Labor, legally accept member savings deposits and make small loans to its members. CACs are relatively small in size (client numbers) and manage smaller total loan portfolios. By 2002, there were 180 credit and savings cooperatives in Nicaragua each with an average of 331 clients and an average loan portfolio of US$156,000.

The structure, function, and regulatory status of CACs are different from unregulated and regulated microcredit institutions. Some CACs utilize techniques common to other microcredit institutions and encounter the same challenges. For the purposes of this thesis, most CACs, specifically those not affiliated with the professional association of microcredit institutions (discussed below), are not included as MFIs. Two CACs are affiliated with the association of microcredit institutions: CEPRODEL and C. 20 de Abril. One other long-standing CAC, Caruna, was a part of the association of MFIs until recently.

ACCION International and FINCA International) or as start-up projects receiving funding and technical support from international development NGOs (including Catholic Relief Services, Caritas, World Vision International, and Mennonite Economic Development Associates). Alongside these internationally affiliated programs, local development organizations initiated microcredit projects as a part of their services, and a number of local independent microcredit-specific programs also appeared. These programs either functioned as an arm of legal non-profit NGOs or, in the case of stand-alone microcredit programs, were soon incorporated as non-profit institutions under the law.

In December 1990, the United Nations Development Programme (UNDP) sent ACCION International, one of the largest and oldest microfinance agencies in Latin America supported by USAID, to Nicaragua to "assess the financial needs of Nicaragua's microentrepreneurs" (ACCION 2011). With the technical and financial help of ACCION, the Austrian government, and the Inter-American Development Bank, a group of Nicaraguan private businessmen established the non-profit Fundación para el Apoyo a la Microempresa (FAMA) with the goal to resolve the serious problem of unemployment and the lack of resources for those who cannot access bank credit. FAMA's vision was to provide their clients with credit opportunities to help their families and communities get ahead through their own hard work and efforts. The non-profit institution began loaning in 1992 in the communities of Masaya and Chinandega.

A 1994 report by NITLAPAN research institution demonstrates the distribution of rural finance by producer class and finance source (Jonakin and Enriquez 1999). The NGO microcredit sector served 23,226 individuals with total credit at US$3.4 million. While the new sector served double the number of small-scale producer clients that BANADES served that year, the average NGO loan was US$146 compared to the

average US$2,312 BANADES offered. Together, the number of small-scale clients served by BANADES and NGOs was nearly half the number provided on average with credit in the 1980s.

The efforts, though, lacked cohesion, cooperation, and a long-term vision for the sector's development (Jonakin and Enriquez 1999; van Dijck, Nusselder, and Sanders 2004). Changing goals and limited resources from external funders in the international donor community affected the potential of microcredit programs. In 1999, a number of early MFIs united and formed *La Asociación Nicaragüense de Instituciones de Microfinanzas* (the Nicaraguan Association of Microfinance Institutions), ASOMIF, to represent and support the interests of its member institutions and the national microfinance industry. The objectives of ASOMIF have been to promote and strengthen the institutions of its affiliates in order to foster the development of the micro and small business sectors in urban and rural Nicaragua. ASOMIF represents its affiliates and the microfinance sector in relevant debates and legal subjects at the national and international levels.

Bilateral donors, multilateral development agencies, international financial institutions, and private first-world foundations and investors provided the key start-up funds and support for the initiation of the country's first microcredit programs and institutions in the 1990s. As van Dijck, Nusselder, and Sanders (2004) and Flaming et al. (2005) argue, the microcredit sector in Nicaragua emerged and expanded largely from the major role of international development donors and agencies. External institutions and organizations created and encouraged the creation of a number of MFIs with the goal of providing credit for poor households and microentrepreneurs.

The Nicaraguan government has played an active, facilitating role in channeling foreign aid resources to the emerging microcredit sector. In 1993, the government of

Norway granted US$4 million to the Nicaraguan government for the creation of *El Programa Nacional de Apoyo a la Microempresa* (PAMIC), a national program to support microenterprise. PAMIC (today known as INPYME) channeled the foreign credit funds to rural producers through financial intermediaries. Fourteen NGO microcredit institutions informally made up the PAMIC network[6] (van Dijck, Nusselder, and Sanders 2004). In 1996, the primary donor to PAMIC, then the Netherlands, pulled out to be replaced by the UNDP and the countries of Scandinavia and Switzerland, which created programs to continue to develop the microfinance sector in the country (van Dijck, Nusselder, and Sanders 2004).

In a 2000 summary of the microfinance sector, Findley identifies the major sources of funds in the private microcredit industry: 1) loans and credit lines from international governments (the German Gesellschaft fur Internationale Zusammenarbeit, GTZ), international and regional development banks (IADB and Banco Central de Integración Económica), and private investment funds and institutions (NICA Fund); 2) technical assistance support and donations from international organizations (Interamerican Foundation and international affiliates); and 3) donations and loans from bilateral government donors and multilateral development agencies (USAID). The flow of international monies in Nicaragua forms a complicated map that begins from bilateral and multilateral development groups and development investors that lend monies and donate funds to a series of second-tier institutions (including El Fondo de Crédito Rural and others) and private banks (Financiera Nicaragüense de Inversiones, FNI, and Banco Centroamericano de Integración Económica, BCIE, for example) that in turn disburse

[6] Including six MFIs later affiliated with ASOMIF: ASODERI, CEPRODEL, Fundacion Nieborowski, Fundacion Leon 2000, FUDESI, and ACODEP (van Dijck, Nusselder, and Sanders 2004). Many other early microcredit programs fell outside the scope of PAMIC.

loans and technical assistance to hundreds of microcredit institutions (Flaming et al. 2005).

CGAP's 2005 report on effectiveness and accountability in Nicaragua's microcredit sector suggests "too many donor agencies are channeling too much money through too many channels, with a surfeit of expectations about what credit can achieve for the poor" (Flaming et al 2005:6). In 2005, some 23 bi- and multi-lateral donor agencies and 5 private investors funded microcredit in Nicaragua. CGAP found that the incoherent overfunding fragmented the sector and at times produced competing efforts and duplicate programs. Moreover, the double, sometimes triple, lending involved in the flow of funds through second-tier institutions complicates funding requirements and, with add-on fees at each level, even raises costs to the end borrower.

THE SUSTAINABILITY DEBATE ENTERS NICARAGUA'S MICROFINANCE SECTOR

Microcredit first developed in Nicaragua when pressures for institutional financial sustainability and efficiency had not quite become the priority in the global microfinance industry (van Dijck, Nusselder, and Sanders 2004). Many small early NGOs worked with the goal to provide credit to entrepreneurs and producers excluded from the commercial credit market. By the end of the decade, efficiency and operational sustainability were the new rule (van Dijck, Nusselder, and Sanders 2004). MFIs were judged in terms of their efficiency (administrative costs to portfolio) and level of subsidization (amount of external grants and subsidized loans received). But most MFIs did not live up to the efficiency and sustainability standards. Nicaragua's microfinance sector is characterized by a high level of external subsidization and dependency on foreign aid and investment. The World Bank found Nicaragua's institutions to be weak, highly inefficient, and

undermined by high interest rates and overfunding (World Bank 2003). Van Dijck, Nusselder, and Sanders (2004) reported that one study showed that a group of 7 MFIs received an average of 60 percent of their total loan portfolio in external interest-bearing loans. Moreover, they estimated that only 10 percent of specialized MFIs might be able to generate enough independent revenue to be sustainable.

With mounting pressures from external funding sources to conform to best practices to ensure financial viability, several microcredit organizations committed to introduce mechanisms and practices to reduce their lending risks and ensure their long-term viability (Jonakin and Enriquez 1999). Nicaragua's early microcredit programs quickly adjusted their practices that would match global microfinance industry strategies and traditional banking practices to recuperate loan monies. For borrowers with sufficient property and assets, MFIs would now require standard collateral, which could include farm animals, household appliances, the harvest or a property title (Jonakin and Enriquez 1999). For those borrowers without collateral, a few organizations developed group lending and joint liability models (though these group models were often not the primary loan methodology) (Findley 2000). These organizations also opened local branches in target communities and rural areas and employed local personnel to improve the organization's access to information on clients, their businesses, and their ability to repay (Jonakin and Enriquez 1999). Interest rates on loans were modeled to reflect market conditions. By the latter half of the 1990s, interest rates reportedly averaged between 23.4 percent—almost 10 points higher than the average among the other Central American countries (van Dijck, Nusselder, and Sanders 2004). Organizations began to "diversify" their lending portfolios by including various economic sectors in their credit programs; in other words, some programs included non-poor clients and medium-sized, established businesses in their client base. Recovery rates improved and provided more stable funds

for the growing microcredit programs. Regardless of improved recovery, most microcredit organizations chronically relied (and generally still rely) on external funding sources to cover operating expenses and expand microcredit programs.

The legal status of microcredit institutions in Nicaragua prohibits them from collecting operating capital from other potential sources. With the legal status of non-governmental organization—the status all but two[7] of Nicaragua's MFIs hold today—the institutions do not fall under state supervision by the Superintendency of Banks. Although the MFIs may grant and manage loans, these organizations are restricted from accepting savings deposits or providing other financial services, such as insurance and remittance payouts. The NGOs have the ability to transform into regulated commercial institutions, which in turn are have the legal right to hold savings deposits from the public. However, many MFIs cannot afford the costly process and portfolio minimums to bring the institutions under the regulation of the Superintendency. Donor agencies have continued to grant subsidized loans to fund MFIs and, except in a couple of cases, have not provided the capital and technical assistance to undergo transformation into regulated institutions. Moreover, as regulated financial institutions, the MFIs would be subject to requirements more in line with formal banking and have to tighten the structure of loans, leading to the exclusion of the target population the MFIs intend to serve.

THE NICARAGUAN GOVERNMENT RESTRAINS MICROCREDIT INTEREST RATES

In 2000, the Central Bank published a notice in *La Prensa* that interest rates in the national financial system had reached over 79 percent (Astacio 2000). Law 176, established in 1994, regulated the interest rates on loans between individual entities—in

[7] The two regulated MFIs are Banco Procrédit and FAMA. The third institution to achieve regulated status, Banex, was liquidated in 2010.

this case, the legal definition includes MFIs—to no more than 50 percent more than those charged in the private banks (*Ley 176*, 1994; Blanco 2000). This meant that MFIs could legally charge up to 120 percent annual, or 10 percent monthly, interest rates to its clients.

In response to the concerns of interest rate abuses, in 2001 the Nicaraguan National Assembly approved Law 374, "Regulating Loans between Private Individuals," which set a maximum interest rate for loans between private individuals to the average variable rates charged by the country's commercial banks—on average less than 18 percent (*Ley* 374, 2001; Sandoval 2000). Some lawmakers hoped the regulation would cap potentially excessive interest rates and provide equal, or at least better, terms of loans for microcredit borrowers (Corea 2001). In practice, the law has not been consistently enforced and may, in fact, have made MFIs less transparent in their activities (Flaming et al. 2005). Despite the law, MFIs continue to provide loans with market-based interest rates with additional default rates and fees to clients (Nuñez, Guerrero, and Bravo 2005; Flaming et al. 2005). In 2004, MFI's self-reported annual interest rates on average varied between 18 and 24 percent for the agricultural sector and 30 to 36 percent for the commercial sector, but rates could reach 60 percent (Moncada 2004).

The microcredit sector rallied against Law 374 and the idea of a government-imposed fixed interest rate. A capped rate, microcredit leaders argued, was not reflective of the supply and demand of credit in the market, and the rate would not cover the costs of delivering credit to MFI borrowers (Corea 2001). ASOMIF presented several proposals to the National Assembly to establish an official special regulatory framework for the growing microfinance sector to ensure its long-term stability and integration. ASOMIF's proposal would apply the banking law to establish interest rates and allow lenders to "freely agree upon interest rates," disqualifying Law 374 (van Dijck,

Nusselder, and Sanders 2004). The proposed legislation would bring the microcredit industry under the supervision of a new committee consisting of members from the Superintendency, the Ministry of Industry, and a representative from ASOMIF. Regulations would be compulsory and institutions would be subject to audit and rules of transparency. Most importantly, as regulated but still non-profit institutions, under the law proposed by the microfinance sector, MFIs would be allowed to accept savings deposits from clients. Then president of ASOMIF, Armando Garcia, argued that the law was necessary for microcredit lenders to expand their coverage and help more persons to rise out of poverty (López 2004). The proposed law, however, stalled in the National Assembly. Though finally approved in principle in 2004, special committees eventually rejected the law. In midst of debate, the Assembly clearly signaled that it would not approve the capture of savings deposits for non-bank entities (Nuñez, Guerrero, and Bravo 2005).

THE STATE OF THE MICROCREDIT SECTOR AFTER THE FIRST DECADE

The microcredit industry in Nicaragua grew dramatically in the first decade. From 1997 to 2001, loan portfolios managed by the country's microcredit programs grew annually by an average 47 percent (Lacayo 2002). In 2001, the 16 MFIs associated with ASOMIF had 123 urban and rural branches in the country.[8] According to ASOMIF data reported in 2001, the MFIs reported 128,589 clients with an average loan size of US$468 and a total loan portfolio of over US$51.5 million. The average loan default rate was 5.6

[8] The 16 MFIs that made up ASOMIF at the end of 2001 were the following institutions (in order of largest loan portfolio December 2001): FDL, ACODEP, FAMA, CEPRODEL, CARUNA, PRODESA, Fundacion JOSE NIEBOROWISKI, PRESTANIC, FINCA Nicaragua, FIDESA (later BANEX), Fundenuse, ASODERI, Fundacion León 2000, Fundacion 4i – 2000, PROMUJER, and FODEM.

percent. Unregulated NGO MFIs managed about 60 percent of microcredit resources and served 73 percent of borrowers (van Dijck, Nusselder, and Sanders 2004).

A majority of the loan monies were distributed for agriculture and livestock (35.1 percent of the total loan portfolios) and commerce (37.9 percent). Most of the ASOMIF institutions made loans for agriculture and livestock activities (13 of the 16 surveyed by Findley [2000]), with some institutions dedicating as much as 90 percent of credit to the agricultural sector. In comparison with the microcredit markets in Honduras, Guatemala, and El Salvador, Findley (2000) finds that agricultural credit was a significant part of microcredit programs in Nicaragua, and microcredit for agriculture was insignificant or non-existent in the three other Central American countries. All MFIs also made loans for commercial business purposes. Less than half of the institutions made housing and consumption loans, which totaled 2.4 and 7.3 percent of the total microfinance loan portfolio, respectively.

In a survey of 26 MFIs in Nicaragua, Findley (2000) found that individual lending was utilized much more than group lending. Almost all institutions primarily lent to individuals, and a few also lent to groups of borrowers. In Honduras, Guatemala, and El Salvador, group lending was the predominant loan methodology used by MFIs. Zamor, Morin, and Aviles, in a 2002 study of five microcredit institutions, reported that all institutions used individual loan methodology and only one institution used solidarity groups. The authors noted that previously, three institutions had used group lending methods, but had since discontinued group lending for supposed problems with loan recuperation. Loans were mostly short-term in length. Over 60 percent of credit was distributed in loans with repayment schedules of one year or less, and just 14 percent were in the forms of loans with two years or longer repayment schedules.

Effective annual interest rates on microcredit loans reached as high as 94 percent for commerce and 37 percent for agriculture, much higher than elsewhere in the region. For individual loans, microcredit institutions solicited physical material guarantees in order to grant loans (Zamor, Morin, and Aviles 2002). Guarantees could be tied to land and homes for greater loan amounts and other possessions of value for lesser amounts. In cases of default, microcredit institutions entered into private legal processes against their clients to recuperate loan monies or collateral (López and González 2000).

Women reportedly received 49.1 percent of the total loans monies distributed by ASOMIF institutions, although early ASOMIF reports do not include the actual number of female clients. Deugd (2004) reports that women accounted for near half of all clients, but women represent only 38 percent of clients in rural areas; moreover, women in rural areas only received 17 percent of loan monies. Deugd argues that this difference can be attributed to a number of reasons. Traditionally, credit has been concentrated in the hands of male heads of household. Typically, women do no have high-value collateral or other resources to back loans in higher amounts. Women are also more likely to work in less-productive activities with lower returns in the informal sector, and women have more demands on their time, energy, and resources as female heads of household.

On average, Deugd continues, rural women receive loans with higher interest rates and shorter repayment schedules. This may be due in part to the activities in which women participate—more likely commercial or retail with expected higher, quicker returns on profit. Loans for activities such as agriculture and livestock—typically male dominated economic activities—may be structured with lower rates with longer schedules for expected lower returns over longer periods of time. Without collateral, women are also most often participated in group or liability lending programs when available.

After the first decade of microcredit development in Nicaragua, credit remained markedly concentrated in urban areas (van Dijck, Nusselder, and Sanders and 2004). ASOMIF data shows that Managua, the largest city, consumed 20 percent of credit resources. Including four other smaller cities, over half of credit was distributed in urban areas. Along with its urban character, microcredit was concentrated in regions with an average higher economic status. Most of the credit available (47.6 percent) was concentrated in the departments classified as "low" level of poverty. Those departments listed as experiencing "severe" poverty received just 9.3 percent of the loan portfolio.

A study on the microcredit sector for the World Bank by Legovini (2003) revealed that only borrowers in the top 10 percentile benefited economically from microcredit loans. Those in the bottom 70 percentile suffered a net loss from borrowing. Legovini shows that the welfare conditions of poorer households in fact deteriorated when they borrowed and as the availability of cash loans expanded, the incidence, depth, and severity of poverty increased. The author concludes that in Nicaragua loans "are not good policy instruments for reducing poverty" (in World Bank 2003). In response to the Legovini study, the World Bank cautioned that microcredit in Nicaragua may not be a poverty-reducing instrument. The Bank identified credit as a potential strategy for the non-poor, but insisted microcredit may not be appropriate for the very poor.

The microfinance sector emerged as the post-1990 Nicaraguan state rolled back responsibility for development to private entities. The new institutions that entered, backed by large amounts of external funding, provided some credit resources to microbusinesses in the absence of state and formal credit. As the microfinance sector developed in Nicaragua, certain trends appeared. Most microcredit funds were lent to individuals; men received a great portion of the monies available; credit was concentrated in urban and less-than-poor areas; and collateral requirements were common. In a 2003

review of the microfinance sector, Legovini indicated that Nicaragua's poor were unlikely to benefit economically from microcredit and the World Bank suggested that microcredit might only have some use for non-poor borrowers. In the next chapter, I present the case of protest against microfinance that dramatically appeared on the public scene in 2008.

Chapter 5: Borrower Protests: El Movimiento Del Norte

> No podemos esperar más. La lucha es justa.
> (We cannot wait anymore. The struggle is just.)
>
> Protest chant during a 10-day road blockade

> Credit like this is like a cancer. It's the interest that kills you.
>
> Maria, small business owner participating in the protests (personal interview with author, July 7, 2009)

In April 2008, Banco ProCrédit, a regulated microfinance institution, arranged for the arrest of six clients with overdue microloan debts. In response, over 400 agricultural producers and small business owners who had current microloans with local microfinance institutions parked hundreds of vehicles on the Pan American highway, the main corridor between Managua and Honduras, and blocked traffic for three days. "We cannot wait anymore, the struggle is just," they cried as they occupied the highway. The demonstrators, organized as *El Movimiento de Pequeños Productores, Comerciantes y Microempresarios del Norte,* MPCN, pressured the MFIs to halt the illegal incarcerations and seizures of property as payment for any overdue debts. They demanded that the MFIs negotiate and restructure the unfair and overly burdensome terms of their loans. "We ask that they [the MFIs] allow us to catch our breath and let us get back to our lands and our businesses and produce. We want to pay our debts; we just want to pay what is fair and just," expressed Jose Padilla, one of the local leaders of the organized movement (personal interview with author, July 7, 2009).

Maria, the owner of a small clothing store in Ocotal, Nueva Segovia, took out a US$500 loan with a microfinance institution to help her buy more inventory. "I got

wrapped up for the necessity, to help my business, to make improvements. But it wasn't enough" (personal interview with author, July 7, 2009). When sales remained flat, Maria could not keep up with the monthly repayment, and soon fees and penalties added up to more than double the principal loan. She joined in the MPCN protests in 2008. I spoke to Maria in 2009 in a demonstration in front of the National Assembly.

> So here I am. I involved myself in the movement because I had to. I had no choice. I could not pay and this was the only way to try to get them to review my loan. I cannot imagine what they would have done had I not joined. I know families who have made payment of their loans, but had nothing to feed their families. I know one family who lost their home—can you imagine that? They [the MFIs] are leaving whole families on the street, without a place to go, without anything to eat. It is only fair what we ask for. We just want a chance to pay what is fair and manageable for us and not have to fear losing our homes, or having nothing to eat (personal interview with author, July 7, 2009).

Maria's story reflects some of the main concerns expressed by other borrowers. They borrowed with the intention of making a small investment, but when the results were not enough to support repayment, they found themselves facing default and increasing debts. Borrowers often used the term "drowning" to describe their experience struggling to make payments on their loans. Maria also points to the sacrifice that some borrowers make in order to satisfy repayment—in this case, that families go without food. Others still end up selling household goods, assets, and property for cash to make payments, or wait until the MFI moves in to collect on collateral.

Eduardo, a rural rancher from Madriz, received news that a judge had issued an order for his arrest in 2008. He joined the protests hoping that the MFIs would drop the orders and renegotiate his loan.

> I am fleeing capture and arrest. If I go back without anything, surely the pressure against us and the persecution will just get worse. They charge

> and charge and charge you interest and fees and you keep paying and paying. All the money you have goes to the loan, so it is like you are just working like a slave for the bank. Then when you cannot pay, it is even better for them because they take your land and your home and sell it for more than you owed. You lose everything. They are the only winners (personal interview with author, July 7, 2009).

Eduardo faced mounting social and psychological pressures to repay, and when he still missed full payment, he received an arrest order. He saw no way out of a loan and compared the burden of microdebt to a life of slavery. In his perception, the borrowers were the "losers" in the relationship with microfinance.

Padilla, the regional leader of the protests, owns a medium-sized ranch and employs a handful of workers. He had a relatively large amount of outstanding debt with his property as collateral. After a particularly difficult year, the beginning of the 2008 global slowdown, Padilla found himself with low return and more debt. He approached the MFIs that he owed and explained his changing economic position, but the MFIs did not change his repayment amount or schedule. When other small landowners in the area were evicted from their lands, Padilla decided to organize with other individuals indebted to local MFIs and demand terms payable for those struggling with debt (personal interview with author, July 5, 2009).

The borrowers turned to public protest to demand critical changes in the structure of their outstanding microloans and the nature of their relationship with the MFIs. The borrowers urged MFIs to lower the annual interest rates on their debts to 8 to 12 percent, remove all default penalties, and extend payment plans for up to 5 to 10 years. They charged the MFIs with practicing usury—charging extremely high interests and fees—and exerting severe pressure on borrowers in default to make overdue payments. MFI workers would harass borrowers, even neighbors and family members of a borrower in default, in attempts to receive payment. Leaders of MFIs manipulated the judicial system

to enact arrest orders and hasty evictions of borrowers and their families from their homes and lands. The overly burdensome loans and excessive means of collection, they argued, meant that many borrowers would never be able to repay and may lose their means of survival and their home to microdebt. The borrowers of the MPCN continued with sporadic protests on major highways and in front of MFI branches in key towns in northern Nicaragua for the next few months.

In late June, local and national political delegates and the leaders of ASOMIF met with the leaders of the MPCN in Managua. Over several days of heated debate, ASMOIF agreed to reevaluate a limited number of clients' previous debts on a case-by-case basis and to extend their payments due for a few more months. The MFIs did not agree to lower interest rates, extend payment plans, or halt the seizure of property. They also refused to deal with the collective demands for renegotiation. The agreement was signed on July 5, 2008 by the representatives of the MPCN, ASOMIF, and FAMA, the only regulated MFI (of three at the time) that participated in the negotiations (Padilla 2008). Days after the agreements, the MPCN charged two MFIs, Banco ProCrédit and Fundenuse, with refusing to receive borrowers requesting renegotiation and thereby breaking the agreement set in Managua (Vanegas, Alvarez, and Pantoja 2008).

During the summer of 2008, members of the MPCN continued to blockade the highway and demonstrate in front of MFI branches in several rural and semi-rural towns in the departments of Nueva Segovia, Madriz, and Estelí in northern Nicaragua. By mid-July, the leaders of the movement claimed that they had organized 3,280 borrowers, ranging from small to medium-sized agricultural producers to small formal and informal business owners to salaried workers, and from those in default under threat of arrest or eviction to those who continued to make their payments but still needed restructuring of their loan terms with microfinance institutions.

During a speech in Jalapa to celebrate the upcoming 29th anniversary of the Sandinista revolution, President Daniel Ortega addressed the borrowers of the MPCN and encouraged those with outstanding debts to maintain the protest: “You have done well in protesting against the usurers…. Plant yourselves in front of their offices. Stay firm; we support you” (Vanegas and Aleman 2008). The demonstrations continued with almost daily protests. On July 22, as police attempted to escort staff out of Fundenuse in Ocotal, a group of protestors, several bearing machetes and Molotov bombs, attempted to set fire to the building. Anti-riot police responded with tear gas and rubber bullets against the crowd and several protestors and police were seriously injured (Vanegas and Aleman 2008). Reacting to the escalating protests, several MFIs temporarily closed their doors and threatened to withhold the disbursement of hundreds of thousands of dollars in loan funds for upcoming harvests, and even to cease entirely their operations in the rural north (Navas 2009).

In October 2008, leaders of the MPCN presented a draft of their demands to local Sandinista deputies in the National Assembly with the intention of creating special legislation in their favor (Padilla, personal interview with the author, July 5, 2009). Their proposal included the reduction of the interest rates charged by MFIs to 12 percent annually, the implementation of a six-month grace period, and the cancellation of all default interest charges and fees. They also asked that repayment plans for borrowers with less than US$10,000 in debt be extended by four years and by five years for those with more than US$10,000. In addition, the proposal required MFIs to stop all judicial actions—detentions, salary embargos, and seizure and sale of property—against the borrowers. Sandinista deputies argued that the special law would only apply to the list of borrowers who had fallen into default and made their demands before June 30, 2009; the law was a unique case and would not extend to other or future borrowers. MPCN leaders

insisted that they would not make any payments on their debts with the MFIs until the Assembly approved the law.

Over the next months, the MPCN continued to pressure MFIs to renegotiate. They also began to pressure the national government to intervene in the renegotiation. By January, the MPCN claimed over 10,000 borrowers had joined their movement (Padilla, personal interview with the author, July 5, 2009). In the evening on January 12, 2009, thousands of borrowers took to the Pan-American Highway miles north of Managua and formed an eight-hour long road blockade to pressure the government to take measures to ensure the renegotiation of debts with the MFIs (Álvarez Hidalgo and Canales Ewest 2009). The blockade, formed of armed protestors and burning tires, backed up traffic for miles. Around 200 anti-riot troops armed with tear gas were dispatched to clear the blockade, but once the protesters were dispersed, other protestors were waiting to form another roadblock several miles away. As troops cleared the second roadblock in the early hours of the morning, the demonstrators moved and planted themselves in front of the National Assembly to demand state assistance in their struggle.

THE STATE REACTS TO THE MPCN

After President Ortega's public comment in July 2008, the administration remained silent in respect to the protests. In early 2009, reports swirled that Ortega still maintained his support of the protestors, but insisted that they still continue to repay. In July 2009, MPCN protestors packed the glass-separated viewing room of the Nicaraguan National Assembly and waited anxiously for the results of a vote to move the *Ley de Moratoria* (Moratorium Law) to the Economic Commission for review and revision. Outside, hundreds more demonstrators lined the streets awaiting the vote. The vote on the

draft of the *Ley de Moratoria (*formally *La Ley Especial para el Establecimiento de Condiciones Básicas y de Garantía para la Renegociación de Adeudos entre las Instituciones Microfinancieras y Deudores en Mora* [The Special Law for the Establishment of Basic Conditions and Guarantee for the Renegotiation of Debts between Microfinance Institutions and Debtors in Default]) represented the culmination of frustrated negotiations and over a year of public protest and debate between debtors and microfinance institutions (*Ley* 716, 2010). As the vote opened, deputies one by one rose to stand in show of support for the protestors. To an uproar of applause, the Assembly passed the motion to forward the law to the Commission. In April 2010, the Economic Commission returned their revision of the law to the National Assembly, but with one significant change: the borrowers would be able to renegotiate their microloans at annual interest rates no greater than 16—not 12—percent (Nuñez 2010).

THE REACTION OF THE MICROFINANCE INDUSTRY

The protests and demands of the MPCN and the passage of the *Ley de Moratoria* considerably unsettled the microfinance industry in Nicaragua. At the close of 2009, repayment rates had fallen, and the number of clients in default climbed. The sector's lending portfolio shrank 15 percent (Nuñez 2009). The overall number of microfinance clients fell from over 350,000 the year before to 292,000 (Álvarez Hidalgo 2010). The response of the microfinance institutions, often expressed through ASOMIF, has been to reject changes in its practices; to attack the protestors' moral character and motives; and to restate the importance of the industry for clients, institutions, and the national economy.

The microfinance sector adamantly rejected renegotiation of the terms of their microcredit loans. The institutions had to charge market rates and recuperate loans in a timely fashion in order to cover the costs of its operations, or it would be forced to close and leave thousands of clients without access to microcredit. The manager of one MFI argued that since the rates of default were so low, there was no problem with the interest rates they charged:

> The basic problem with our loans is not the interest rate. The test for this is that of 559,000 clients that we have on a national level, less than one percent of are in the courts. This so-called movement has fifteen hundred people. The conclusion is easy. If the problem were the interest rates, the majority would be in a situation of default, and it is not like that (personal interview with the author, July 20, 2009).

The quantifiable success of microfinance in terms of repayment rates was offered as proof that the terms are not usurious and clients were in general able to repay.

In efforts to discredit the MPCN, ASOMIF attacked the protesters as a small group of borrowers who were just looking for a way out of paying on their obligations. The borrowers only encouraged anyone else with debt simply not to pay: “They would say, Hey, if I, who has always paid well my debt, now I see that there is an organized movement, I will say, If they don’t pay, why should I have to pay?” (personal interview with the author, July 20, 2009). Critics began referring to the protests as *El Movimiento No Pago* (the I Don’t Pay Movement), a name that would stick and repeatedly come up in news headlines on the protests. In the public debate, critics called those who did not pay on their loans lazy, thieves, losers, and charged them with ruining credit opportunities for “good” clients who borrow responsibly and repay on schedule. ASOMIF warned that the borrowers participating in the protests and failing to pay on their debts were named in a database amongst the various MFIs and would not be eligible for credit in the future. The

MFIs also attacked the MPCN for fomenting a greater national problem: a "culture of non-payment" (Editorial, *La Prensa* 2010). To combat the ideas spread by the protests, ASOMIF launched a campaign to meet with clients of MFIs and urge borrowers not to unite with the "No Pago" (Canales Ewest 2009a).

ASOMIF attacked the protests as a politically motivated (Sandinista) effort to undermine the private microfinance sector. In early 2009, *La Prensa* released a story about an alleged letter sent from one regional leader of the MCPN to a political representative within *El Consejo del Poder Ciudadano* (CPC) (Canales Ewest 2009b). In the letter, the MPCN leader supposedly remarks that the movement's goal was to combat the country's entire financial system and instead have the state-sponsored microcredit program, ALBA-Caruna, control all credit resources. The leader denies having written the letter. However, ASOMIF used the report to tie the MPCN to the Sandinista party.

ASOMIF spokespersons defended the industry and maintained the importance of its role in the rural economy in the provision of credit resources—some US$200 million of credit annually—to hundreds of thousands of clients who would otherwise not have access to borrowed capital. ASOMIF repeatedly warned that the instability caused by the MPCN was putting at risk millions of dollars of credit for thousands of small-scale producers and small businesses and could potentially paralyze the country's production and business sectors. In the weeks following the violent protest at Fundenuse in July 2008, MFI branches in northern Nicaragua did close their doors and temporarily cease operations. As repayment rates fell and the numbers of clients dropped, some branches closed permanently in more rural areas, particularly those with greater participation in the protests. *La Prensa* predicted that the closure of these institutions would lead to "total chaos" (Lorío and Cerda 2008).

After passage of the *Ley de Moratoria*, the microfinance sector urged President Ortega to veto the law. Twenty-five international funding agencies (from Switzerland, the United States, France, Germany, Netherlands, Italy, Belgium, Luxemburg, and Costa Rica) published an announcement in the press to express their preoccupation with the deterioration of a favorable climate for investment caused by the actions of the protestors (Roodman 2009). Representatives of the International Monetary Fund (IMF) announced that they would analyze the law and its potential impact on the national economy (Aguilera and Nuñez 2010). They suggested that the approval of the law might affect the present revisions of the IMF macroeconomic program for Nicaragua and reminded officials that the Nicaraguan government had signed a letter of intention in October 2009 to guarantee the stability of the national financial system. Aguerri, president of the *Consejo Superior de la Empresa Privada* (Cosep), admitted that the IMF had made clear its complete opposition to state intervention in the free market. Robert Callahan, the Ambassador of the United States in Nicaragua, and Silvio Conrado, representative of the BCIE, one of the most important microfinance funders in the region, expressed concerns that the law would create economic uncertainty and instability and negatively affect the financial climate for future investment interests (Navas and Álvarez 2010).

THE MPCN AFTER THE *LEY DE MORATORIA*

Borrowers were split after the law was passed. Some celebrated the legal framework that gave them the right to renegotiate their debts under new and more favorable terms. Others, however, rejected the Commission's proposal to increase interest rates and continued to push for further state intervention. The *Ley de Moratoria* established a period of 120 days for borrowers eligible for restructured loans to approach

the MFIs for negotiations. As the deadline passed, just a few hundred of the reported thousands of borrowers had restructured their loans. The MFIs attacked the MPCN and cited the lack of response to the arranged negotiations as further proof that the participants simply did not want to pay back their loans.

Borrowers under one regional leader reemerged in the summer of 2010 with new demands. Unable to negotiate directly with the MFIs for what they considered reasonable terms of repayment, the group turned to the Nicaraguan government and requested that the state purchase the outstanding loans from the MFIs and reestablish them in terms comparable to the semi-state controlled microlending program, ALBA-Caruna (Navas 2010a). At the end of 2010, the Ortega government had not publicly shown willingness to meet these demands, and economists have raised doubts about the state's capacity to purchase the loans. Thousands of borrowers in protest continue with sporadic demonstrations, now planted at the doors of government offices, demanding further state intervention.

Meanwhile, the National Assembly has revived debate on a specialized law for the regulation of microfinance in Nicaragua. The *Ley de Microfinanzas* (Microfinance Law) would establish the regulation of MFIs under the Superintendency. The law, first introduced to the Assembly in 2004, had stalled in debates. In discussions with Assembly deputies, ASOMIF representatives have petitioned for the inclusion of the legal authorization to capture savings deposits from clients, receive and pay remittances, and manage insurance and payment services—functions reserved to formal commercialized financial institutions. ASOMIF has also urged for the law to override the *Ley de Préstamos entre Particulares* (Loans between Entities Law) and to codify MFIs' use of "free" market-based interest rates (Navas 2010b). Under pressure from the IMF in late 2009, the Nicaraguan government agreed to take steps to foster greater regulation and

transparency in the country's microfinance sector. However, the Assembly has refused to allow these measures with concerns of how the state would regulate the sector. Freddy Torres, vice-president of the Economic Commission, reported an internal debate around the implementation of interest rate caps at a maximum rate of 60 percent (Alvarez Hidalgo 2010). As 2010 came to a close, the state of the microfinance sector in Nicaragua was still unsettled.

The MPCN emerged when desperate borrowers faced difficulties repaying their debts. Having defaulted on their loan repayment, mounting fees and interests only compounded the borrowers' debt and dampened their prospects for repayment. Local microfinance institutions refused to alter the terms of the loans and proceeded with their collection processes. In extreme cases, borrowers in default were evicted from their homes or thrown in jail. Frustrated by the strict loan conditions and the severity of the consequences of default, the borrowers organized to demand that the MFIs renegotiate in fair terms for struggling borrowers. When MFIs rejected the notion of negotiation, the MPCN turned to the state to create special, client-centered and client-protective legislation. In the next and final chapter, I analyze the case of the MPCN and consider how the experiences and demands of the borrowers reflect the critique of microfinance as a hegemonic discourse that supports neoliberalism.

Chapter 6: Conclusions and Discussion

> No one should be surprised at the reaction against the microfinance institutions. The protests are a reaction against the economic abandonment in which we Nicaraguans have lived for nearly 20 years. Look, microcredit is not a solution for the poor. If it were, poverty might have diminished in the past two decades in Nicaragua. But look around. It has not. Instead, we're worse off than we were before.
>
> Carlos (personal interview with author, July 7, 2009)

The MPCN protests represent microcredit borrowers' dissatisfaction and frustration with the practice and nature of microfinance in Nicaragua. Their struggle for fair loan terms and client protections is a struggle for reprieve from the burdens of microfinance debt in their daily lives. Their demands and critiques strike at the heart of the microfinance discourse and the hegemonic ideologies on which it relies. The protests mark a significant moment for Nicaragua's microfinance industry and the mainstream market-led approach to development.

The borrowers who join the MPCN are not all, or not even a majority, of the total number of microcredit clients in Nicaragua, but their political impact has been significant. Without a large, random survey of the protestors, it is difficult to gauge accurately the breakdown of participants in terms of their economic status, gender, political affiliation, geographical region of residence, type of business activity, or type of loans accessed. The MPCN itself is not entirely cohesive, with different regional leaders and individuals within the groups with different circumstances that brought them to participate. By witnessing and tracking images and video of public demonstrations, tracking representations in national press, and speaking to participants, I have tried to

develop a sense of who these borrowers are, what brought them to the protest, and what they demand as a result. I suggest that the MPCN both reflects an overall snapshot of microfinance lending trends and clientele in Nicaragua.

To begin, the MPCN appears to have a majority of male participants. This more or less reflects the uneven division of credit resources among male and female borrowers: while more than half of Nicaragua's microcredit clients are female, more than half of microcredit monies are lent to men (more women receive small loans and fewer men receive larger-sized loans). Moreover, MPCN participants overwhelmingly are not the poorest of the poor—and some are arguably not even poor—but most of them are economically vulnerable. They are landowners, small to medium-scale farmers, small business owners, and salaried workers. Many of them obtained their microcredit loans by virtue of their access to some sort of physical collateral, especially land. As Nicaragua's microfinance sector has increasingly pursued market-based models, MFIs have directed loan monies to individual borrowers instead of solidarity groups, and increasingly required physical collateral and relied on strong loan recovery mechanisms.

The stories of these borrowers present us with new narratives about microfinance. In these narratives, many microcredit borrowers do not experience positive or empowering impacts as a result of their participation in microcredit. Rather, they face spiraling debts, loss of their means to income, homelessness, and greater poverty. As Maria commented, the experience can be compared to that of cancer eating away at her, eventually leading to a form of death. The borrower is not uplifted through his or her relationship with microfinance; rather she suffers as a result of unfair and unequal relationships with the usurious institutions. Such narratives starkly conflict with the countless "success stories" dominating the microfinance discourse.

Through their stories, the borrowers in many ways reproduce the ideal client subjectivities constructed within the microfinance discourse. Borrowers insist that they are responsible borrowers. They invested their loans in their income-generating activities, and they worked hard. The MCPN demonstrators, however, also discuss their vulnerability as poor clients. Regardless of smart investments and hard work, they are poor or economically vulnerable. While the microfinance discourse might acknowledge that their clients are poor, their poverty is second to their industrious, responsible, and creative character that will lead to their ultimate success. The protestors, however, refer to their vulnerability to underscore their susceptibility to market fluctuations, personal emergencies, and natural disasters that affect their lives and their chances for repayment. The market is precarious and not their route to their exit from poverty.

The borrowers make specific demands for better loan terms—lower interest rates, more flexible and longer-term repayment schedules, and stronger protections during difficult times. Interestingly, what they describe are clearly *not* microfinance loans. The type of loans they need and want are not loans with terms determined by market-based rates and assumed unmet demand, but rather client-centered loans that take into account the nature of their needs. Ultimately, the borrowers are rejecting the notion of "self-help" through markets as the guide for development in private spheres. Rather, they insist on state intervention for, at the very least, client protections and institutional oversight. Borrowers without other potentially effective recourse, turn to the state to outline and enforce regulation of an industry that has relied on market freedoms to determine interest rates.

Moreover, the borrower protests position the economic, social, and psychological well-being of microcredit clients as an important marker of microfinance success. This challenges the sector's reliance on indicators such as repayment rates, efficiency,

outreach and financial sustainability to judge its success and justify its value to society and the economy.

The position taken by Nicaragua's microfinance sector reconstructs the logic of a market-based approach to development. Microfinance leaders argue that the purportedly high levels of unmet demand for credit and the high borrower repayment rates surely indicate that clients want these loans, are willing to accept the terms, and are overwhelmingly capable of repaying. Furthermore, the microfinance sector argues that it must charge market rates, reflecting the high cost and risk involved in lending to their target clients, in order to sustain its lending program and increase its outreach. Through strong, stable institutions, the microfinance sector can bring more credit opportunities to more borrowers. The microfinance sector adamantly rejects state involvement in the market-based nature of their practice. ASOMIF opposes any legal restrictions on interest rates and collection recovery as threats to the potential sustainability of institutions.

By attacking the MPCN borrowers, the microfinance industry reinforces the ideologies underlying the microfinance model and its ideal client construction. The sector claims that these protestors are not the hard-working, rational entrepreneurs exemplified in the microfinance discourse. As the microfinance sector frames it, they are shameless thieves who did not work hard enough or use the money the right way, and regardless, they did not responsibly pay back their loans. Their actions put at risk the promise of national economic development as well as availability of credit resources for hundreds of thousands of responsible borrowers.

The state, through various actors, has communicated varying levels of support for both the MPCN and the microfinance industry. Since microfinance emerged in Nicaragua in the 1990s, the state has generally encouraged and facilitated private, unregulated microfinance and has played an active role in channeling resources. However, at various

points, the state has reigned in the microfinance sector, particularly in the establishment of interest rates, and created legal measures in efforts to protect against potential abuses. In this case, the state responded to the some of the demands of the MPCN and passed special legislation in their favor. The passage of legislation marks a real change for the relationship between microfinance and the state, one in which the state insists on a position of more control over the sector's activities in relation to its clients.

However, the state has yet to define a clear position on microfinance. Ortega's current administration has increasingly involved itself in the direct provision of low-interest, small loans to the poor groups via ALBA-Caruna. While Caruna has grown to play a significant part in the microcredit sector, its lower rates and more favorable terms for poorer borrowers have not significantly encouraged other MFIs to lower interest rates.

While some protestors now encourage Ortega's administration to play a new role as direct provider of microcredit for poor Nicaraguans, the state's capacity or willingness to do so is unclear. Moreover, the state has treaded lightly to not upset the microfinance sector and external funding agencies and, in accordance with recent IMF agreements, the National Assembly has revived discussions on the creation of a regulatory environment for microfinance.

As Bateman (2010) argues, microfinance and its focus on individual self-help and personal responsibility for daily survival thwarts the opportunity for the poor to pursue more transformational politics, such as labor organizing, social movements, and pressuring governments for more pro-poor policies. In Nicaragua, however, borrowers have joined together in collective protest to challenge the current microfinance trends and make their claims on the state. Understanding the perspectives of borrowers—and development beneficiaries in general—is useful because it complicates the larger development discourse (Shakya and Rankin 2008). In this case, the borrowers' resistance

and demands have significant implications for microfinance and market-led development in Nicaragua and worldwide. Their protests reveal the limitations of microcredit as a tool for poverty alleviation and economic development. For these borrowers, microfinance does not empower them to lift themselves out of poverty as the hype had promised. Microfinance, and in particular commercialized microcredit, is not a cure-all for poverty. As borrowers react to these realities, microfinance practitioners, states, and the international development community will be forced to respond to resistances and challenges to the hegemonic microfinance paradigm.

In light of the limitations of microfinance, I suggest a reimagining of the current microfinance models and the market-led approach to development and replacing it with a client-centered, rights-based approach to economic development. I argue that states might create more responsive models of development based on the basic rights and protections for the poor. As Shakya and Rankin argue, this "involves a more fundamental rethinking about the relations between states and the market, since it begs the question of financial sustainability" (2008:1232). States might be forced to rethink the role of state-led development programs and subsidies in order to meet the needs and conditions of the poor. Moreover, states might consider investing in human and physical capital—infrastructure, health, education, technology, and industry—to support and protect the poor and encourage stable local markets. Simply, we might reimagine a very different development model that reflects the voices, the needs, and the rights of the poor.

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