Moving from failed ‘anti-developmental’ microcredit to a ‘developmental’ local financial system in South Africa: exploring key institutions, problems and prospects

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Background

- A very central apart of sustainable economic development is essentially about trying to ensure a country's scarce capital is channelled:
    - A). **INTO** the most productive growth-oriented enterprises
    - B). **AWAY** from/not wasted on the least productive enterprises
- 'Pure' market profit-led intermediation is one way to do this – looks brilliant on paper, elites certainly like it.....
- but very inefficient (waste, speculation, depressions, etc) and gives rise to massive inequality wherever most approximated to (Piketty 2014)
- Central planning – also looks good on paper and seems fair….
- but in practise was way too bureaucratic and inefficient

Background

- History overwhelmingly shows instead that some sort of state 'guidance' allied to an industrial policy have proved to be the best long-term way of building a productive economy

- The work of heterodox economists such as Amsden, Block, Chang, Evans, Johnson, Lazonick, Nelson, Taylor, Wade, Winter, etc, is hugely enlightening on 'developmental state' and industrial policy aspects

- There is no perfect method here though – many mistakes have been made, but, as Chang says, not all such experiments worked, **but history provides no successful economies that did NOT implement such a policy**….

- and there is not just *one* method either, but many different ways depending on the local context (culture, politics, economy, social)

- However, through experience we are much nearer to finding out some of the **KEY** institutions, organisations and regulatory requirements that go together to form an effective 'developmental state'

Post-apartheid South Africa

- 1955 Freedom Charter spelled out many interventionist pro-poor financial institutions, such as development banks, coop funds, mutual banks, etc

- but all these heterodox ideas were dropped in 1994 to placate US government, World Bank, IMF and white South African elite

- Instead, South Africa embarked on building a fairly conventional market-driven private sector-led financial system

- After all, the neoliberal paradigm was pretty much at the peak of its influence in the early 1990s, so everyone was pushing it….

Microcredit comes to South Africa

- In South Africa, neoliberal financial sector policy very much included an emphasis upon upping the supply of commercial microcredit
- Microcredit, it was widely said, would soon lead to a bottom-up miracle of poverty reduction and local enterprise development
- Already some USAID-funded projects ‘showing the way’ under apartheid – Get Ahead Foundation (GAF), Small Enterprise Foundation (SEF), etc

A word on microcredit around the world

- Lots of positive talk about microcredit from Muhammad Yunus, Hernando de Soto, USAID, World Bank, and others
- but today the microcredit model is increasingly coming to be seen as a policy disaster similar to central planning – the intentions were good, but the policy was flawed from the very start……
- Yes, we have flood of anecdotes showing impact, but this is an illusion as most clients actually lose assets and end up in debt….
- Some gamblers win in the casino, but no-one actually claims that therefore poverty can be reduced by gambling!
- In fact, generalised over-indebtedness is main outcome (Bolivia, Peru, Mexico, India, Bosnia, Bangladesh including Jobra village…)
- No evidence of any gender empowerment – women's life chances determined as individuals and by 'the market' – return to life in 1800s!

A word on microcredit around the world

- Commercialised microcredit has led to generalised and quite spectacular sub-prime-style profiteering everywhere
- It's a process that David Harvey calls 'accumulation by dispossession'
- Investors pile in after 2000 while managers do very well – **this** provides the primary incentive for the expansion of microcredit, not any evidence of any poverty reduction
- Mexico's Banco Compartamos revealed as huge benefit to managers, investors and even the US-based advisors…..
- but no evidence of any real positive impact on the poor women clients, as everywhere else
- The bad news confirmed by the UK government-finance systematic review of the evidence undertaken by Duvendack *et al* (2011) who conclude that 'the case for microfinance has been built on foundations of sand'

A word on microcredit around the world

- Most important development problem is that microfinance drives the creation of unproductive ‘no-growth’ informal microenterprises and self-employment ventures…

- …means major opportunity cost as formal SMEs are increasingly ‘crowded out’ of the financial supply chain

- Cambodia, 45% of finance is intermediated through microcredit institutions up from @5% in 1995, followed by Bolivia (40% - @10% in 1990), and others

- Why are we then surprised to see these economies mired in unproductive informal microenterprises and no SME growth and no development?

- Local economies are increasingly ‘dumbed down’ - that is, informalised, primitivised, disconnected and deindustrialised - and so become structurally incapable of making any real endogenous progress.

- As they say in Bosnia, when the local economy is ‘Africanized’ its all down hill from then on….

So what has been the impact of microcredit in South Africa?

- Many promises from the international development community of huge impact
- Donor funding comes on stream
- Many local consultants and financial institutions jump on board simply to make money

So what has been the impact of microcredit in South Africa?

- However, the results have been a disaster:
- Most microcredit used for consumption spending – South Africa now one of the most indebted countries in the world
- Very little real enterprise development has taken place – like casinos, GAF and SEF can count on a tiny number of 'successes' (winners) but when set against the large numbers of exits (losers) there is no real progress
- Pointedly, no discussion of 'displacement' when already struggling micro-entrepreneurs lose out to new generation of microcredit-assisted businesses
- Over-expansion and artificially-stimulated competition actually served to **reduce** average informal sector incomes in the poorest communities after 1994
- But business elite (mainly white) has done brilliant from microcredit - lots of new self-employed cooks, gardeners, cleaners, etc – which raised inequality and destroyed inter-ethnic solidarity even more…..
- Huge amount of profiteering taking place, mainly by white banks and microfinance institutions …..Capitec become South Africa's Banco Compartamos equivalent

Urgent need for a ‘developmental’ local financial system

- Many developed and developing countries have a model of local finance that works
- Model emerged over history, via trial-and-error, and which now helps us identify the core components of this ‘developmental’ local financial model
- There are three core aspects:
  - Cooperative finance
  - Local state-led finance
  - ‘Embedded’ local private banks

Cooperative banking

- Examples from Italy, Spain, Scandinavia, Germany, Brazil show way forward
- Mobilises local capital better if community-owned and aims to benefit community (e.g., create local jobs)
- Financial cooperatives and cooperative banks have all developed efficient ways of providing long-term support for local MSME development – we can learn from them
- And they have largely avoided speculation – USA credit unions now expanding as big banks abandoned
- Democratic management is better for community, returns dividends, avoids profiteering by managers

Regional/local state banking

- Post-war Germany and Italy did great things, pioneered important methodologies, also Taiwan and South Korea, and then China through local government ran UCCs and RCCs, and Vietnam….

- Such banks can usefully feed into an local industrial policy planning and implementation framework

- Have developed ways of providing long-term support for local SMEs on affordable terms and maturities

- Can also tie in usefully with other policies - public procurement, local content agreements, technology transfer, FDI, etc.

- Can link in with central government programs and institutions – Brazil is best example with BNDES and its local programs

‘Embedded’ private banking

- Best examples from Germany, Scandinavia and Italy
- Private (often family) banks ‘embedded’ in tissue of local institutions (Chambers, trade unions, church, etc)
- Develops inside an intangible set of obligations, trust, solidarity
- Becattini’s ‘theory of local bank’ argues that a high trust environment both creates and is sustained by community-oriented local private banks
- Stay local, prefer local and support local
- Useful for working capital
- Far removed form Wall Street-style private banks
- Main problem here is, How to create such banks? – not as tractable as the two previous institutions……

Building a ‘developmental’ local financial system

- Not so easy to build such a 3-cornered ‘developmental’ financial system
- Local context is crucial (cultural, economic, political, social, etc)
- Will meet resistance from existing private sector financial institutions and business sector
- Political will is crucial to overcome elite resistance (best examples are in post-war after elites humbled)
- also needs long-term investment which is hard for politicians to commit to when they need to win elections every 4-5 years

Building a ‘developmental’ local financial system

- Key steps include:
  - Long-term perspective and objectives – do not expected immediate results
  - Build on existing and potential comparative advantages requires solid industrial policy approach in government
  - Capitalise such institutions if necessary, even cooperative banks
  - Cooperative banks require robust regulations or will be taken over by private interests
  - Politicians set the industrial strategy parameters, but do NOT operate the institutions

Conclusion

- Post-neoliberal era we are in now allows for clear thinking free of ideological rigidities – go for 'what works' !
- Alternative models to neoliberal/Wall Street recipe are actually well known and historically accomplished
- Key is how best to adjust to local situation
  - "[R]ecognising institutional diversity should not be confused with the argument that therefore there are no lessons to be learnt […] It is both possible and instructive to identify some major principles that underlie […] successful experience, and to try to adapt the policy tools and institutional vehicles that were used to realise those principles in order to fit local conditions elsewhere, and if necessary devise new policy tools and institutions. Indeed, if East Asian governments had themselves believed in the impossibility of such institutional adaptation and innovation and had ignored earlier success stories, it is doubtful whether we would have an East Asian Miracle to discuss."

Akyuz, Chang and Kozul-Wright