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The Age of Microfinance: Destroying Latin American Economies from the Bottom Up

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List of Abbreviations

CDBs	Community Development Banks
CEDEZO	Centros de Desarrollo Empresarial Zonal
CEPAL	United Nations Economic Commission for Latin America
CONQUITO	Agencia Metropolitana de Promoción Económicá
CORFO	Corporación de Fomento de la Producción de Chile
EIU	Economist Intelligence Unit
EPM	Empresas Publicas de Medellín
FINCA	Foundation for International Community Assistance
IDB	Inter-American Development Bank
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPO	Initial Public Offerings
ISI	Import Substitution Industrialisation
LEDAs	Local Economic Development Agencies
MFI	Microfinance Institutions
NGOs	Non Governmental Organizations
PDPs	Productive Development Policies
SAPs	Structural Adjustment Programs
SENAES	Secretaria Nacional de Economia Solidária, Brasilia
SMEs	small and medium enterprises
UNDP	United Nations Development Program

Abstract

This article argues that the microfinance model that arrived in Latin America in the 1970s has proven, as elsewhere around the world, to be an almost wholly destructive economic and social policy intervention. Centrally, I argue that the microfinance model is responsible for embedding and giving continued impetus to an adverse 'anti-development' trajectory in Latin America's economies, one that has progressively helped to de-industrialise, infantilise and informalise the overall local economic and social structure. Until recently, the extent and precise nature of this 'anti-development' trajectory has been ignored for fear of undermining and delegitimizing the global microfinance model and, with it, the dominant political-economic philosophy – neoliberalism – that essentially gave life to it. Effective local industrial policies and 'pro-development' local financial institutions are now urgently required in Latin America to build genuinely sustainable and equitable solidarity-driven local economies from the bottom up.

Key words

microcredit, microfinance, neoliberalism, productivity, deindustrialisation

1. Background[1]

As originally conceived, microfinance[2] is the provision of tiny micro-loans to the poor to allow them to establish a range of income-generating activities, thereby to supposedly escape poverty. Through the establishment and expansion of rafts of informal microenterprises and simple self-employment ventures operating in very basic product and service markets – petty subsistence retail, cross-border shuttle trade, basket-making, simple services (shoe-shining, clothing repairs, bicycle maintenance), street food preparation and selling, handicrafts (including souvenirs to foreigners), individual transport (rickshaws, tuk-tuks), and so on – every poor local community was said to possess the potential to significantly reduce its poverty and catalyse into existence a sustainable 'bottom-up' economic and social development trajectory. All that was required to realise this massive potential was to address the fundamental constraint that supposedly holds back the poor and unemployed in developing countries – a lack of capital. With guaranteed access to a microloan, however, the poor would be able to create and/or expand a microenterprise, generate an income flow, build individual and household assets, and both their and the community's poverty would soon be a thing of the past. Largely premised on such a simplistic but hugely uplifting narrative (De Soto 1986; Yunus 2001, 2007; Robinson 2001; Smith/Thurman 2007; Counts 2008), the microfinance model became one of the most important international development policies to have emerged over the last thirty years, if not *the* most important policy in many important respects (for example, see Balkenhol 2006: 213). Microfinance was very widely said to be 'changing the world'.

The argument I present here, however, is that the microfinance model is indeed 'changing the world', especially in Latin America, *but it is doing so in a very destructive fashion* (see also Bateman 2010, 2011; Bateman/Chang 2012). It is not just that microfinance does not work as microfinance advocates contend that it does, but that it actually constitutes a very powerful 'anti-development' intervention that locally embeds poverty, deprivation, inequality

1 I thank Juan Pablo Duran Ortíz, Hugh Sinclair and Julia Smith, plus three anonymous referees, for useful comments. However, the usual disclaimer applies.

2 The term microfinance was coined in the 1990s as the umbrella term for the proliferating variety of micro-initiatives, including microcredit, micro-savings, micro-insurance, etc. However, we will use the term microfinance here simply because it is the more generally accepted one.

and backwardness. Through a number of transmission mechanisms the microfinance model is causally associated with the progressive de-industrialisation, infantilisation and informalisation of the local enterprise sector and local economy. This, in turn, is a trajectory that ultimately destroys the capacity for raising productivity, and so also the possibility of securing sustainable development, growth and long-term poverty reduction.

The article starts in Section 2 with a brief outline of the history of the microfinance movement since its establishment in the 1970s before Section 3 presents the ‘anti-development’ argument. Moving to the situation in Latin America, Section 4 provides a brief exploration of the pre-microfinance period before Section 5 focuses upon the arrival of the microfinance model in Latin America and confirms that several countries have reached a stage of ‘saturation’ – Bolivia, Colombia, Mexico and Peru. Using data from a number of recent surveys undertaken by the World Bank and other bodies, Section 6 briefly discusses some of the emerging impacts of microfinance in these four Latin American countries. Section 7 then outlines the crucial support to the argument being made in this article that is provided by the Inter-American Development Bank (IDB) in its path-breaking 2010 publication ‘*The age of productivity: Transforming economies from the bottom up’*. Section 8 touches upon the resulting need for pro-active local industrial policies to emerge in Latin America. Section 9 presents a conclusion.

2. Background to the microfinance model

As is well known, the modern microfinance movement is most closely associated with the work of Dr Muhammad Yunus, the US-educated Bangladeshi economist and future Nobel Peace Prize recipient (in 2006). It was Yunus’s work in the village of Jobra near Chittagong, and the apparent success of the iconic Grameen Bank he established in 1983, that convinced him very early on that he had found the answer not just to Bangladesh’s endemic poverty, but to global poverty in its entirety. Importantly, Yunus took great pains to portray microfinance as a vital way of legitimising and promoting capitalism in developing countries, essentially ‘bringing capitalism down to the poor’. Rather than militating against, passively resisting or suggesting viable alternatives to capitalism, Yunus raised the possibility that the poor would begin to see microfinance as their best chance of obtaining a better life, a way of becoming a successful micro-capitalist with an interest in nothing more than acquiring one’s own small piece of the action. Yunus soon took to claiming that microfinance would ‘eradicate poverty in a generation’ and he confidently predicted that our childrenwould very soon have to go to a ‘poverty museum’ to find out for themselves what all the fuss was about (for example, see Yunus 1997).

Helping the poor through self-help and individual entrepreneurship in this way would also mean the poor not having to call into play any of the ‘collective capabilities’ and state-coordinated institutional vehicles and policies that were historically decisive in promoting development and poverty reduction in the developed western economies. By this we mean trade unions, social movements, basic income programs (e.g., pensions, unemployment insurance), the cooperative movement, and ‘developmental state’-type structures. Most of all, discussion of any meaningful redistribution of wealth and power – which historically is seen as the single most important way of resolving endemic poverty (Green 2012) – could be permanently taken off the political agenda. To the relief, if not delight, of the corporate and political elites that most western governments and the international development agencies really represent, the poor could now be safely left to escape poverty through their own individual agency.

A further far-reaching turning point in the establishment of the microfinance model came in the 1990s when the original subsidised Grameen Bank model began to be phased out and replaced as ‘best practice’ by a for-profit commercialised version. This move had to be made because the vast bulk of microfinance institutions (hereafter MFIs) that had sprung up around the developing world in the wake of the Grameen Bank experiment were, like the Grameen Bank itself, very much dependent upon outside subsidies from international donors and their own governments. With the 'full cost recovery' mantra then very much in vogue in the neoliberal policymaking community, this subsidisation element was completely unacceptable. Under neoliberal rules, overall efficiency is assured when all organisations in society are able to 'earn their keep on the market' (on this, see World Bank 2002). This rule applies not just to business enterprises, naturally, but to all manner of other organisations, including government services (healthcare, education, transport, etc), NGOs, voluntary associations, and also development-focused institutions like MFIs.

The long-term solution to the 'problem' of subsidies in the microfinance sector was found in the idea to reconstitute microfinance as a privately-owned, profit-driven business model. Key advocates of this business model were Maria Otero and Elizabeth Rhyne, both then at the leading microfinance advocacy body ACCIÓN (see Otero/Rhyne 1994), and Marguerite Robinson, who was then at the now defunct Harvard Institute for International Development (Robinson 2001). These high-profile microfinance advocates saw the new commercialised microfinance model, and the likely increase in the supply of microfinance, as capable of generating enormous benefits for the poor. Led by USAID and the World Bank, the original Grameen Bank model of subsidised microfinance was thus phased out and replaced as 'best practice' by the new commercialised microfinance model. Just as predicted, the supply of microfinance massively increased in the years after the commercialisation revolution, to the point where many developing countries are now officially defined as 'saturated' – that is, every single poor person can very easily access as much microcredit as they wish.

Notwithstanding all such optimism, a credible link between the microfinance model and genuine progress on poverty reduction and 'bottom-up' development still remains elusive. Many analysts have touched upon some of the obvious drawbacks to the microfinance model, including with regard to the lack of genuine evidence of poverty reduction (Rogaly 1996; Gulli 1998; Elyachar 2005). Others explained this difficulty by arguing that microfinance was actually driven far more by neoliberal ideological imperatives than any genuine concern to eradicate poverty (Bateman 1999, 2003, 2006; Weber 2002; Bateman/Ellerman 2005; Feiner/Barker 2007). However, in the face of a massive PR effort on behalf of the microfinance movement, supported by a flood of hugely unrepresentative anecdotes and case studies, the importance of this independent research was almost completely ignored.

But things began to change very dramatically in 2007. The catalyst for this change was the Initial Public Offering (IPO) of Mexico's *Compartamos* in the summer of 2007, an event that saw its senior managers self-rewarded with windfalls of several tens of millions of dollars effectively paid for by its poor women clients who were being charged up to 195% interest rates on their microloans. Some external investors also made fortunes from their shareholdings in *Compartamos*, notably the US-based microfinance advocacy body ACCIÓN, and even ACCIÓN's main US-based advisor to *Compartamos*, Maria Otero, managed to amass a personal fortune at the expense of Mexico's poor.[3] Crucially, the massive publicity surrounding the *Compartamos* IPO exposed to the international development community, and to the general public as well, the unethical behaviour, naked greed, and outrageous Wall Street-style financial rewards that have become the hallmark of the commercialised microfinance sector (Sinclair 2012).

However, instead of the microfinance industry accepting the seriousness of the situation, and so fundamentally changing they way they operated in order to try to ensure that microfinance returned to its social mission, the complete reverse process took place: savvy managers

3 In her position as President and CEO of ACCIÓN, it was Maria Otero's role to advise *Compartamos* in the run-up to its IPO. For her efforts, Otero was generously rewarded with a million dollar bonus in 2008, and then a further $550,000 bonus in 2009 just prior to leaving ACCIÓN to join the first administration of US President Barrack Obama as Under-Secretary of State for Democracy and Global Affairs (see Sinclair 2012: 75).

working in the largest MFIs, alongside their growing band of external investors, saw *Compartamos* as the role model MFI they needed to emulate as the best way of ensuring their *own* private enrichment. Several high-profile MFIs were soon found to be broadly following the *Compartamos* model; in India in the form of *SKS* (Arunachalam 2011), in Bosnia in the form of *Mikrofin* (Bateman/Sinković/Škare 2012) and in South Africa in the form of *Capitec* (Bateman 2012a). And very much as in Mexico, no evidence whatsoever has emerged from India, Bosnia or South Africa to suggest that the poor were seeing any sort of improvement in their lives as all this hugely profitable microfinance-related activity was going on (Bateman 2010). Today, in fact, it is widely accepted, even by long-standing supporters (notably Roodman 2012), that there is actually *no* evidence to support the uplifting poverty reduction claims made this past thirty years on behalf of the microfinance model.

Also spurred on by the *Compartamos* scandal, however, were a number of long-time microfinance professionals who began to resent the Wall Street-style greed and unethical behaviour that they considered was taking over in the 'new world' of microfinance. Some of these individuals finally began to speak their mind (Dichter/Harper 2007; Harper 2011; Sinclair 2012). An even more painful body blow to the microfinance industry was then inflicted in 2011, thanks to a UK government-funded systematic review of all the evidence purporting to show a positive impact from microfinance (Duvendack et al. 2011). Instead of finding solid evidence in favour of microfinance, which the UK government clearly hoped would be the case (the UK's aid program has a major microfinance component), the systematic review team were forced to conclude the opposite: in spite of thirty years of operation there was actually very little, if any, solid evidence to support the many positive claims made on behalf of the microfinance model. Centrally, the systematic review team found that all the previous impact evaluations that came to broadly positive conclusions regarding microfinance only did so because they were biased, incomplete, or else used completely inappropriate methodologies (many impact evaluations were undertaken by the MFIs themselves, so this was perhaps to be expected). The overarching conclusion the review team came to (ibid: 75) was that the 'Current enthusiasm (for microfinance) is built on (..) foundations of sand'. It is not going too far to say that the microfinance model today is under an existential threat.

3. Microfinance is an 'anti-development' policy

Much of the recent criticism of the microfinance model points to a 'wrong turning' that has robbed the poor of the benefits of microfinance, and that if only the resulting operational problems can be repaired, then microfinance will return to helping the poor escape their poverty. The commercialisation of microfinance that began in the 1990s is the problem most often cited in this context (a notable example is Sinclair 2012). However, it is also possible to provide a much simpler and more logical explanation for the absence this past thirty years of the microfinance movement of any real evidence of a meaningful positive net impact in the community: *there <u>is</u> no positive net impact in the community*. Arguing along this line, I make the point that the microfinance model is an 'anti-development' intervention, an intervention that unintentionally, but nevertheless programmatically, weakens and ultimately destroys a local economic space.[4] The problem is not so much operational flaws in the microfinance

[4] History has many such models that were introduced with good intentions, including, one might argue, Soviet-style central planning. However, history has also produced some economic models that were *deliberately* designed to destroy an economy. One such model is the 'Morgenthau Plan', the US government plan for post-war Germany that had the explicit aim of turning a previously mighty industrial power into a primitive and poor agricultural country that could never again challenge world peace. The central idea was to obliterate all but the simplest and smallest farms and enterprises with little development potential, backed up by a prohibition on industrial research. However, when it became clear that an economically successful Germany was required to act as a buffer to the possible expansion of communist ideas and influence emanating from the Soviet Union, the Morgenthau Plan was hastily abandoned and replaced by the much more famous, and pro-development, 'Marshall Plan', Reinert 2007). It is telling that in many fundamental respects the 'Morgenthau Plan' is very similar in design, though not in intent, to most microcredit programs today (see Bateman 2010: 93-96)

model, flaws that might possibly be put right given changes, its supporters contend, but the fact that the microfinance model by its very design is fundamentally flawed.

The argument I make here is that microfinance is an 'anti-development' intervention. It is a fairly straight-forward argument. It starts with a more accurate understanding of the real economic history of the developed western economies (Nelson/Winter 1982; Friedman 1988; Chang 2002, 2007, 2011; Reinert 2007), as well as the more recent economic history of the East Asian 'miracle' economies (Wade 1990; Amsden 1989, 2001, 2007; Chang 1994, 2006; Thun 2006). Contrary to widely propagated free market myths and neoliberal ideology, sustainable development and growth in both of these locations was actually very much the outcome of a 'developmental state'. Centrally, state institutions, state coordination and pro-active interventions and policies were vectored into facilitating the establishment and growth of the 'right' enterprises in the economy – 'right' defined here as small, medium and large enterprises that are technically sophisticated, formally registered, operating at minimum efficient scale, innovation-driven, are both horizontally (clusters, networks) and vertically (sub-contracting, supply chains) inter-connected and can facilitate the creation of new organisational routines and capabilities. At the same time, 'wrong' enterprises, which can be defined as simple, informal/illegal, petty trade-based microenterprises and one-person self-employment ventures (on this, see also Baumol 1990), were discriminated against and effectively allocated almost no financial resources.

Going further, a major factor behind the economic success enjoyed by the now rich western countries and later the East Asian 'miracle' countries was the extent to which it was possible, under conditions of financial scarcity, to construct and protect an array of financial institutions that could efficiently intermediate financial resources, on affordable terms and maturities, into the 'right' enterprises and, by extension, avoid providing (wasting) financial resources supporting the 'wrong' enterprises. Various financial institutions were supported in this context. This included central banks, private commercial banks operating under strict regulatory regimes, state development banks, financial cooperatives, urban and rural credit cooperatives, special credit institutes, social venture capital funds, and so on. The precise arrangements governing the operation and coordination of these financial institutions was dependent upon an individual country's own history, economic structure, balance of class forces, international relations, and other idiosyncratic factors. But the general recipe was to mobilise funds and socialise the risk involved in providing long-term affordable financial support to the 'right' enterprises and which the market on its own would not otherwise provide. In many respects, the simple financial intermediation mechanism outlined here is not dissimilar to the financial systems and mechanisms outlined in the important work of Levine and others (see King/Levine 1993; Levine 2005), work that demonstrates that 'better-developed' and 'better-functioning' financial systems that can allocate capital to 'better' new and existing enterprises are an important factor in generating economic growth.

The microfinance model's entire rationale and existence, by complete contrast, is predicated on it being able to efficiently and profitably channel scarce financial resources into precisely the 'wrong' enterprises. Informal microenterprises and self-employment ventures are the dominant clients of MFIs and other financial institutions not just because of their size – *micro*finance is, after all, designed for *micro*enterprises – but also because since the 1970s they were very widely, if not universally, seen as possessing the potential to make a major contribution to bottom-up development (for example, see Levitsky 1989). More recently, quick turnover informal microenterprises are seen by commercialised MFIs as less risky and higher profit propositions compared to formal small or medium enterprises. Higher interest rates also ensure that even if there is a higher rate of default, the MFI is still able to generate an adequate profit.

Comparatively weak and generally short-lived informal enterprises are thus given priority over riskier but longer-term more substantive enterprise development trajectories.[5] Indeed, 'wrong' enterprises are the programmed output of the microfinance model. However, once such a financial intermediation process takes hold, it inevitably sends the local economy along the *exact* opposite trajectory to what we know is the optimal trajectory for the local economy. Beginning with the work of Hart (1973), it became clear that most local communities in developing countries have for a long time been surprisingly well supplied with most simple items and services, thanks to what was termed 'the informal sector'. That is, most communities in developing countries have a small village shop, an agricultural supplies station, a basket-maker, lots of petty services (hairdressing, cafés, bars, etc), many simple forms of transport, a couple of cross-border traders bringing foreign goods into the community, and so on. This creates a very serious impediment to the operation of microfinance programs: other things being equal, unless there is an injection of additional demand in the community, almost all of the informal microenterprises that make up the informal sector expect (if not choose) to remain microenterprises, albeit we might see minor changes in the local market structure and market share on account of some units offering better service, lower prices, etc.

However, the microfinance model is effectively built on the assumption of there being an increase in local demand that will absorb the microfinance-induced increase in the supply of simple products and services. If this were not so, then the microfinance model would not function because it would very quickly come up against a local demand constraint. *Yet this is precisely what happens in practice*. As Amsden (2010) pointed out (see also Galbraith 2008: 151-163), supply-side measures that simply *assume* sufficient demand will be forthcoming to absorb any increase in supply, are fundamentally mistaken. The problem here, of course, is the 'fallacy of composition' - the mistaken idea that what is true of the parts of a whole must always be true of the whole. Thus, *one* new informal microenterprise making baskets that manages to survive in a local economy is taken by the microfinance industry as evidence to show that *all* (or many more) new informal microenterprises also making baskets can achieve the same goal. Indeed, one might describe the 'fallacy of composition' as the fundamental flaw that Muhammad Yunus entirely failed to grasp back in the 1970s, when he was tirelessly promoting his new model of microcredit to the international development community. Yunus's misunderstanding of the 'fallacy of composition' concept wrongly led him into concluding that '[a] Grameen-type credit program opens up the door for limitless self-employment, and it can effectively do it in a pocket of poverty amidst prosperity, or in a massive poverty situation' (Yunus 1989: 156).[6]

Microfinance programs thus promote a programmed increase in the supply of simple products and services, but these programs are *not* automatically met with an equal increase in local demand. The end result is that, inevitably, a high rate of new entry leads to intense competition which in turn leads to a combination of market displacement and enterprise exit. These factors then combine to cancel out almost all of the presumed additional jobs and income impact associated with the initial injection of microfinance (see Bateman 2010: 60-77). Importantly, there is also a negative impact on productivity and growth. Constant 'poverty-push' new entry into already over-crowded local markets selling relatively homogenous goods inevitably trends towards intense local competition and a situation where

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5 The microfinance sector has always been intimately associated with the informal sector. Even in countries where there was a desire that this not be so, it was not possible to change matters. In Bosnia, for instance, the microfinance sector commenced in the late 1990s with a firm commitment to support only registered formal enterprises, based on an understanding that an officially sanctioned expansion of the informal sector would be a very negative development for Bosnia's comparatively advanced industrial economy. However, when it became clear to the MFIs that the overwhelming majority of their potential clients were planning to operate informally, and that the MFIs would thus find it impossible to locate clients, the requirement that an MFI's clients had to be registered was quietly dropped (see Goronja 1999).

6 Indeed, many economists working in Bangladesh in the 1980s *did* point out to Yunus that there were likely to be very strict limits to the applicability of his new microcredit model in Bangladesh, and so also in developing countries in general, precisely because of the local demand constraint problem discussed here – for example, see Ahmad and Hossein 1984.

average returns are competed down almost to zero. Under such extreme microfinance-induced local market conditions, then, the desired organic growth of some/any informal microenterprises into small or medium enterprises associated with much higher productivity is only very rarely possible in practice (for a typical example from Colombia, see Bateman/Duran Ortíz/Sinković 2011).

Moreover, the programmed support offered by microfinance for the ‘wrong’ enterprises directly undermines the activities and growth prospects of the ‘right’ enterprises operating in the same location and/or market sub-sector. This is thanks to the market share that is unfairly taken by informal microenterprises (often just temporarily) solely on account of the lower costs that arise through its heightened ability to engage in tax avoidance, pay lower wages, save on health and safety spending, and so on (Farrell 2004). What we have is a situation where the ‘wrong’ enterprises tend to drive out the ’good’ enterprises, an interesting new application of Gresham’s Law (‘bad money drives out good’). Thus, although it is very widely argued that microfinance can very easily, if not ideally, co-exist with financial support programs targeting formal small and medium enterprises, in practice this is simply not the case: the former creates the unfair competitive conditions under which the latter cannot hope to succeed.

All told, it is wilfully misleading to suggest, as many high-profile microfinance advocates have all too easily done (notably De Soto 1986; Yunus 1989), that the proliferation of informal microenterprises and self-employment ventures will eventually produce a thriving and growth-oriented local economy capable of securing a decent life for its poor inhabitants. As noted above, economic history and contemporary practice simply does not provide any evidence whatsoever to support this argument. Nonetheless, microfinance advocates and neoliberal policymakers are unstoppable and in recent years they have succeeded in elevating the expansion of the ‘wrong’ enterprises into the *primary* goal of economic policy in a great many developing countries, particularly with the help of the World Bank and USAID. This is also increasingly the case in recession-hit developed countries too.[7] Yet this is also why we are increasingly finding the emergence of major structural problems and serious setbacks today in *precisely* those locations most penetrated by the microfinance model (Bateman 2010). Does the evidence from Latin America provide any further evidence as regards the ‘anti-development’ argument?

4. The pre-microfinance period in Latin America

To put into context the analysis of microfinance in Sections 5 and 6 below, it is useful to first briefly review the dominant enterprise development model in Latin America in what we might call the ‘pre-microfinance’ period. Post-war development in Latin America very much revolved around the Import-Substitution-Industrialisation (ISI) policies associated with Argentinean economist Raul Prebisch, especially during his tenure as Chief Economist at the United Nations Economic Commission for Latin America (CEPAL). Prebisch was of the belief that concerted action by the state and other bodies should aim to gradually replace imports of manufactured goods by locally-produced goods, thus capturing the benefits of technical progress as well as creating local employment and wealth generation in high-skill areas. The state became an active participant in building business development, educational and industrial upgrading infrastructures. Although there was some resistance to the ISI concept, particularly from the US government, the policy was allowed through. The first beneficiaries were Mexico, Brazil and Argentina which quickly managed to successfully ‘domesticate’ several key industries, such as clothing and shoes. However, later efforts to produce more

[7] Many depression-hit west European countries are now making microfinance a major aspect of their response, though the rationale behind such a decision is fundamentally flawed – see Bateman 2012b.
Creating Jobs in recession-hit Communities in Europe: Why Microcredit will not help, *Social Europe Journal,* 15th May. http://www.social-europe.eu/2012/05/creating-jobs-in-recession-hit-communities-in-europe-why-microcredit-will-not-help/

sophisticated goods, such as automobiles, were not so easy. In addition, it is said that the failure to also promote exports as robustly as import-substitution was one of the major drawbacks to the ISI model, leading among other things to balance of payments problems and a lack of competitiveness of Latin America's producers (though after ten years of so of ISI policies, exports *did* become a more important concern largely thanks to the technological upgrading effect on import-substitution industries [Amsden 2001: 167-8]).

However, as the Cold War intensified in the 1950s and 1960s, the US government directly, and through its effective proxies the World Bank and IMF, began to resist *any* developing country government that chose to adopt policies involving significant state intervention, no matter what the results achieved in the country concerned (George/Sabelli 1994). Inevitably, the significant element of state intervention that lay behind ISI policies was anathema to the US government. Open hostility broke out. Attempts were first made by the US government to quash the ISI idea in CEPAL and in every other international forum, and second, there was an attempt by the US government to close down CEPAL entirely (Toye/Toye 2006). With the ascendancy of the neoliberal political project in the 1970s, and the international development community's aggressive projection of Structural Adjustment Programs (SAPs) upon all developing countries, however, the ISI model could survive no longer. Under the supervision of the international development community, and also under constant pressure from the US government, nearly all vestiges of ISI thinking were removed. Latin American governments were forced instead to embrace a set of neoliberal policy parameters, a policy approach that also came to be known as the 'Washington Consensus' (Williamson 1990). For the next twenty five years, Latin America was subject to a radical free market embrace that, among other things, eschewed any form of strategic industrial policy, strategic public ownership and directed credit. Enterprises and industries were supposed to rise (and fall) as and when the market dictated. All forms of pro-active state intervention were as much as possible dismantled and discredited (or else broadly continued, but downplayed for political reasons, as in the case of Chile).

As virtually everywhere else, however, very notably in post-communist Eastern Europe (Andor/Summers 1998), neoliberal policies in Latin America proved to be quite disastrous. First of all, almost immediately they precipitated massive bankruptcies and financial crises. Private banks had to be nationalised at huge expense to the taxpayer. In a process now made depressingly familiar to the populations in the developed western countries after 2008 (Krugman 2012), this meant that in the 1980s and 1990s a significant percentage of Latin America's scarce financial resources had to be channelled into (or wasted on) repaying the debts accumulated by governments as a result of saving 'too big to fail' private banks. More significantly, in the long run neoliberal policies failed to deliver anywhere near the promised levels of wealth accumulation and development: on the contrary, such policies manifestly worsened already high levels of poverty, deprivation and inequality that prevailed before 1980 (Weisbrot 2006; Weisbrot/Baker/Rosnick 2006; Navarro 2007). A serious reversal took place across Latin America (excepting Brazil) on almost all important economic and social indicators. For a number of countries, specifically Bolivia, Mexico and Peru, the economic and social situation dramatically worsened under neoliberalism. Already high levels of poverty reached historically unprecedented new heights (see Helwege/Birch 2007: 19-21). Ominously, the situation was deteriorating in Latin America's growing urban areas and, most of all, in its rapidly growing 'cities of slums' (see Davis 2006). By the turn of the millennium, the level of poverty and human suffering brought about by neoliberal policies in Latin America had reached a crescendo.

Not surprisingly, the economic and social failures associated with neoliberalism in Latin America eventually saw those individuals and political parties most associated with it completely rejected at the ballot box. This change was manifest in the so-called 'pink tide' of new leftist governments that came to power in Latin America, starting in 1999 with the late Hugo Chavez's election in Venezuela. Beginning in the late 1990s, therefore, neoliberalism was firmly rejected in one country after another, a process undertaken in tandem with the continent's growing detachment from the political-military grip of the USA. Today, it could be argued, Latin America is leading the world in pioneering many important 'solidarity-driven' economic and social development policies to good effect. This situation, of course, contrasts markedly with the situation in many of the developed countries with a history of proffering advice to Latin American countries, most notably Spain and Portugal, which have entered into prolonged depression.

Despite its problems, the ISI concept was undoubtedly successful in creating a more sophisticated, industrialised and less resource-dependent economic structure in most Latin American economies (see below). Previously backward Latin American countries were finally able to strategically industrialise using their available natural resources and other funds to underpin ISI-type programs. Nonetheless, ISI policies were largely undervalued at the time, if not vigorously disparaged, by mainstream economists.[8] However, the significant benefits of ISI policies have become much clearer in recent years, thanks to a new generation of independent economists and also thanks to the contrast that is now possible with thirty years of neoliberalism. Those who have taken to re-examining the ISI period have come up with a much more accurate picture of the real achievements of ISI policy. Notable among those re-evaluating ISI policies is the late Alice Amsden, who concluded that ISIs were vitally important to early industrialisation progress made in Latin America, just as they lay at the very heart of East Asian success after the 1950s (Amsden 2001, 2004). The difference, Amsden noted, was that the East Asians were more successful than the Latin Americans in moving to promote exports as well. Chang (2007: 27-8) agrees with Amsden as to the over-looked achievements of the ISI model, pointing out that per capita income in Latin America actually grew at 3.1% per year during the 'bad' old years of ISI (1960-80) while it grew at only 0.5% under supposedly much better neoliberal policies (1980-2004).

Moreover, we also need to highlight the important case of Chile. For a long time portrayed as the one country that has been a neoliberal 'success story' in Latin America, and thus the widely deployed counter-argument to ISI policies, it is now largely accepted that Chile actually owes its economic success to a raft of heterodox ISI-style policy interventions and pro-active institutions (a good summary is Agosin/Larraín/Grau 2011). Manifestations of this heterodoxy start with the state's ownership of CODELCO, the world's largest copper producer and one of the most profitable facilities in the world. Rather than being privatised into the hands of eager entrepreneurs in the aftermath of Chile's US government sponsored military coup in 1973, CODELCO was allowed to remain in state hands and it continued to channel a significant percentage of its revenues into the state budget. This decisively helped Chile to finance many of its most important industrial development and social programs (though it was also used to equip the Chilean army, navy and air force). Then came the establishment of a number of powerful state-led industrial development bodies and social venture capital funds, most notably *Fundación Chile* and CORFO (*Corporación de Fomento de la Producción de Chile*). These bodies have patiently developed and financed entirely new enterprises, enterprise clusters and entire export sectors from scratch, the most famous examples being farmed salmon and soft fruits (see Kurtz 2001; Schrank/Kurtz 2005: 686-8).

In general, then, there is little doubt that the overall sophistication and depth of Latin America's industrial base was decisively improved thanks to ISI policies (even if hidden from view, as in Chile). In particular, at the local level many small and medium enterprises (SMEs) were able to get started and to upgrade by providing substitutes for imported goods and intermediate goods to be used in local supply chains involving local large enterprises. The

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8 We now appreciate much more from studies of economic history that this criticism, emerging as it did in the Cold War era, was very often biased, unfair and deliberately inaccurate As Häring and Douglas (2012) point out, the economics profession, especially in the USA, has a long and rather undistinguished history of framing its analysis and research conclusions in line with the requirements of the prevailing capitalist ideology and politics, inevitably producing spurious results and opinions. See also Ferguson (2012) for how similar practices in the economics profession in the USA helped to precipitate the global recession starting in 2008.

importance of these specific points is that we can begin to contrast the partial but still important achievements of ISI policies over a similar period of time during which the microfinance model has reigned supreme in Latin America. How have these important industrial development trajectories and achievements fared during the 'age of microfinance' that followed?

5. Microfinance comes to Latin America

Largely thanks to extensive US government funding and technical assistance programs, a good number of microfinance programs got underway in Latin America from the 1970s onwards. The dominant rationale behind this growing support was clear: the perceived need to provide the poor in Latin America with the *hope* of a way out of their grinding poverty, and maybe even some small successes too, but all to be achieved in such a way that it did not jeopardise in any way the business elites that traditionally ruled these countries and who reflexively supported US government foreign policy in Latin America at virtually every turn. This global objective was US government policy at the time (Chomsky 2003) but also, importantly, given its reach into governments into Latin America, World Bank policy too (George/Sabelli 1994).

In Latin America the first moves to establish the microfinance model came in the 1970s in Brazil, where a number of microcredit programs began with the assistance of the Boston-based microfinance advocacy body, ACCIÓN, using a large amount of USAID funding. However, Bolivia was the first country in which the microfinance movement was to achieve a really significant breakthrough. When the World Bank, USAID and Jeffrey Sachs famously arrived in the early 1980s to restructure the ailing Bolivian economy according to neo-classical textbooks and through its own Structural Adjustment Program, one of the central policy innovations was to recast the then subsidy-driven Grameen Bank-style microfinance model as a commercial operation which would be entirely financially self-sustaining. Through the example of *BancoSol*, an NGO converted into the world's first commercially-oriented microfinance bank, Bolivia effectively showed the way for commercialised microfinance to expand right around the globe (Rhyne 2001). Other microfinance programs also getting underway in Latin America included FINCA (Foundation for International Community Assistance) founded by John Hatch in 1984, with nearly two thirds of its funding provided by USAID. Also joining the microfinance movement was the Inter-American Development Bank (IDB) which began many programs of its own. Significant impetus for the microfinance model was also famously provided by the Peruvian economist, Hernando de Soto, who incorrectly postulated in the mid-1980s that the expansion of the informal sector would be the salvation for the continent (see de Soto 1986).[9] Colombia and, later on, Mexico too, were also seen as pioneers of the microfinance movement in Latin America. Again, US government support was important in helping these countries develop their microfinance sectors.

By the 1990s, the microfinance model was thoroughly embedded within Latin America's economies and financial systems. Significant resources began to shift into microfinance applications, including into consumption lending, and out of other applications that were much less profitable and/or higher risk, notably working with registered SMEs. By the 2000s, the 'absurd gap' that was widely seen as constituting the most important problem preventing significantly increased microfinance impact – an hypothesised gap between the supply of microfinance and the demand for it – appeared to have been well and truly resolved right across Latin America. This was undoubtedly the case in the four countries I propose to examine in a little more detail in this paper.

9 The informal sector has risen markedly in Latin America in the 1990s (Lora and Márquez 1998: 9) and beyond, while, among other things, poverty levels also increased significantly during this period. A marked deterioration in the poverty level notably took place in two countries - Peru and Bolivia - that were among those registering the largest increase in the informal sector (Helwege/Birch 2007).

In Bolivia, microfinance 'saturation' arrived as early as the late 1990s. Christen estimated the size of the Bolivian microfinance market in 1999 at just over 232,000 microloans, yet the microfinance sector by then had already disbursed nearly 380,000 microloans, thus giving a market penetration rate of 163% (Christen 2000: 24). As later became apparent, this manifest over-supply precipitated the world's first 'microfinance meltdown' that took place over 1999-2000. The microfinance sector only managed to recover when some key MFIs withdrew from the Bolivian market, notably a Chilean consumer lending institution. Later on, when the government of leftist Evo Morales was elected into office in 2006, the microfinance sector continued to grow fast, but it also now came under much greater scrutiny in terms of the real role it played in poverty reduction and sustainable development. With many reservations concerning the real development role of the microfinance model, the Morales government put the microfinance sector under much stricter oversight and control. For example, interest rates were capped to an extent and other measures enacted to slow down the growth of the sector. In spite of these restrictions, the London-based Economist Intelligence Unit (EIU) in its prestigious *Microscope 2012* publication still continues to rate the Bolivian microfinance sector very highly (EIU 2012). Indeed, thanks to its robust regulatory framework for deposit-taking, accounting capacity and voluntary compliance with IFRS (International Financial Reporting Standards), Bolivia is rated by the EIU as the world's second best country for microfinance. Importantly, the microfinance sector in Bolivia now accounts for as much as 37% of the total financial sector (Vogel 2012). This fact is not unrelated to the growing recognition that Bolivia has once more reached over-saturation with microfinance, and personal over-indebtedness problems are looming on the horizon (see Gonzalez/Javoy 2011).

Peru is also considered as a pioneering country in terms of the rapid growth in the supply of microfinance (Conga/Inga/Webb 2009). Even in the aftermath of the global financial crisis of 2008, rapid growth has been maintained. At the end of 2011, Peru had US$8.8 billion in microloans across 3.6 million active borrowers, representing more than 10% of Peru's population. Peru's microfinance sector is also largely self-funded through deposits, with US$6.6 billion in deposits involving 3.5 million depositors, almost as many as borrowers (Vogel 2012). Perhaps not surprisingly, for the fifth year running the EIU's *Microscope 2012* rated Peru the world's top country for microfinance, especially in terms of the extent of competition and for its possession of a sophisticated regulatory environment (EIU 2012). By all accounts, too, however, the Peruvian economy can be said to be 'saturated' with microfinance, so there is no practical constraint whatsoever to the poor accessing just as much microcredit as they want. In fact, just as in Bolivia, there are growing indications that an over-supply problem is becoming a real danger in Peru (for example, Kappel/Kraus/Lontzek 2010; Olteanu 2011).

Third, the microfinance sector in Colombia has grown very fast this last twenty years, with the result that Colombia is today just outside the top twenty most 'saturated' countries in the world (Bateman 2011: 4). The increase in supply has come from new MFIs, but also very much from the commercial banking sector downscaling into microfinance (Bateman/Duran Ortíz/Sinković 2011). The government has taken a strong interest in promoting rapid growth of the microfinance sector, though not, it is quick to add, if this involves exploitation of the poor through high interest rates. For that reason, Colombia has been one country (Bolivia is another) where interest rate caps have been deployed. However, intense lobbying pressure by many of Colombia's leading commercial banks recently succeeded in getting the Colombian government to raise the interest rate cap from its initial level of 33% to 53%. Even though the evidence points to there being an over-supply of microcredit already, the argument justifying the changes to the interest rate cap was publicly based on the idea that the supply of microcredit would be increased as a result. Perhaps the real reason for the change, many have speculated, was the fact that the leading commercial banks and MFIs in Colombia, which were already highly profitable at the old 33% cap, simply wanted to emulate their Mexican counterparts (see below) and be in a position to raise their interest rates in order to make even higher profits than ever: which is exactly what they did. Admittedly, with much higher interest rates and profits now possible, many more foreign banks have shown a willingness to enter Colombia's microfinance market. So the supply of microfinance *has* increased. But the result of this foreign entry has been to add yet more fuel to the fire of personal over-indebtedness, which is now getting completely out of hand. Of particular concern is the very dramatic rise in consumer credit in recent years: consumer credit as a percentage of total private lending went from just 16% in 2000 (Jiménez/Manuelito 2011: 49) to reach a massive 42% by 2012.[10] In spite of these emerging problems, in terms of the management of the microfinance sector, the EIU's *Microscope 2012* still rated Colombia seventh in the world's top countries for microfinance (EIU 2012).

Finally, the microfinance sector in Mexico remains one of the most complicated and, by most recent accounts, most 'saturated' in the world. To microfinance advocates, the massive increase in the supply of microfinance in Mexico in the 1990s and 2000s remains one of the most dramatic pieces of evidence in favour of the commercialisation of microfinance (Otero 2007). However, the serious problems that have emerged in precise tandem with increased commercialisation have been simply ignored. Central among these problems is the fact that, contrary to all neoliberal theory and microfinance advocates' predictions, the highly deregulated and ultra-competitive microfinance market in Mexico has generated ultra-high and rising interest rates. This was most graphically shown when it emerged that the high profits made by *Compartamos* are today being generated thanks to interest rates of around 195%,[11] a significant rise on the interest rates applied in earlier years. Such ultra-high interest rates are, of course, one of the reasons that since 2007 foreign banks have been desperate to have a presence in the Mexican microfinance market. Not surprisingly, recent informal reports put the Mexican microfinance system at some considerable risk (Das 2009), with the level of multiple lending now apparently way ahead of that in Nicaragua in the run up to its own microfinance meltdown in 2010.[12] In particular, there has been a significant and worrying jump in the supply of consumer credit since 2000, going from just over 32% of total private lending to 43% by 2009 (Jiménez/Manuelito 2011: 49).[13] By 2011 consumer credit accounted for 23% of all bank-issued credit and, the obvious rationale behind the growth, 40% of all bank earnings arising from interest, commissions and annual fees (UNAM 2012, quoted in Faze/Mazer 2013). Thus, though the EIU's *Microscope 2012* rated Mexico highly – equal ninth place overall – it felt the need to issue a warning to the effect that over-indebtedness in Mexico was becoming a real concern, particularly in the south (EIU 2012:46).

In sum, the growth in microfinance in Latin America this last decade has been quite spectacular. It now accounts for around 45% of total lending with the total portfolio now reaching $27.6 billion across 18 million clients (OECD/UN-ECLAC 2012: 92). It seems clear that the supply of microfinance in Latin America in general, and in these four countries in particular, has reached a point where we may describe the microfinance market as 'saturated'. The key issue today, in fact, is how to avoid further Bolivia-style 'boom-to-bust' scenarios, given that the risk of such a scenario is clearly rising in all of the four countries covered in this article. The pressing *development* question to ask now, however, is, What impact is this largesse having on poverty reduction and sustainable bottom-up development? To date only anecdotal evidence has been produced by the microfinance industry to support

10 *Superintendencia Financiera de Colombia*. 2013. http://www.superfinanciera.gov.co/

11 See 'Does Compartamos charge 195% Interest?' David Roodman's Microfinance Book Blog, January 31st, 2011. http://blogs.cgdev.org/open_book/2011/01/compartamos-and-the-meaning-of-interest-rates.php

12 Information provided by a confidential informant under contract to one of the main microfinance investment institutions operating in Mexico. See also Rozas, 2013.

13 Not all institutions are worried about this rise in consumer spending, of course. Walmart's local business, *WalMex*, is on record as actually looking forward to the likelihood of much stronger (albeit temporary) demand for its mainly imported products thanks to the poor getting into even deeper debt. See 'Strong consumer credit growth positive for retailers, particularly Walmex'. *Business News Americas*, March 9, 2012. http://www.bnamericas.com/news/banking/strong-consumer-credit-growth-positive-for-retailers-particularly-walmex-ubs

their case that there is a causal link between the generous supply of microfinance in Latin America and gains in terms of development, growth and poverty reduction. Even worse, much of the ‘evidence’ provided to justify microfinance largely relates to the mere *increase* in the supply of microfinance and the related issue of the financial sustainability of MFIs: that is, the operational metric has become the impact itself (a good example of this deliberately deceptive ‘goal rotation’ technique is Berger 2006). In the following section, we explore a little further the impacts to date and the relevance of the ‘anti-development’ model to Latin America’s microfinance experience.

6. Key impacts in four microfinance ‘saturated’ countries

Bolivia

Thanks to the growing dominance of the microfinance model in financial intermediation in Bolivia, it seems abundantly clear that the country has very much experienced the destructive ‘anti-development’ dynamic outlined above. As noted, first, a very significant and still growing percentage of Bolivia’s available financial resources (principally its savings and remittance income) are now intermediated by the country’s microfinance sector (around 37%). The microfinance sector thus plays a very central role in financial intermediation in Bolivia, probably more than in any other country in Latin America, if not globally. Commercial banks in Bolivia derive their capital from deposits and bond issues, and with few mechanisms to pass on risk to others in the financial system (such as insurance companies and pension funds), they effectively have to seek out lower-risk/high profit projects. Informal microenterprises and one-person self-employment ventures fit the bill perfectly: hence the ‘downscaling’ into precisely these areas of business. On the other hand, managers in Bolivia’s formal enterprise sector rate ‘access to finance’ as the third most important barrier they have to overcome (World Bank 2011a: 4), suggesting that they are clearly not finding it anywhere near as easy as the typical informal microenterprise to access financial support. Predictably, informal microenterprise activities have expanded to become the most dominant group of clients for the microfinance sector in Bolivia (Baldivia-Urdininea 2004; Brett 2006).

The overall result is that the Bolivian economy has seen very rapid growth in the informal sector since the arrival of the microfinance sector in the late 1980s, but comparatively little development (and getting less year by year) in its far more productive formal small and medium enterprise sectors. The financial dichotomy identified above has, as predicted by the ‘anti-development’ model, increasingly de-industrialised, infantilised and informalised the average local economy in Bolivia. More than 52% of non-agricultural workers are employed in the informal sector (ILO 2012). The obvious visible representation of this negative outcome is that of El Alto, the once tiny suburb of La Paz that is now, since 1988, a separate metropolitan area and home to over 700,000 mainly poor individuals. Such is the extent that informal petty street trading serves as the default employment opportunity for this increasingly desperate and immiserated population, El Alto is now routinely described as nothing more than ‘a giant shopping mall’ with virtually everyone involved in selling on the streets (Gibb 2008).

Moreover, all indicators point to the fact that the local economy is not just dominated by informal microenterprises and self-employment ventures, but also that the vast bulk of formal and informal microenterprises that *do* manage to operate in the industrial sector are extremely weak as well. In the 1990s, according to Fajnzylber/Mahoney/Rojas (2006: 11), productivity in Bolivia’s ballooning microenterprise sector was the lowest in all of Latin America. Since then Bolivia’s microfinance sector has become even *more* reluctant to fund industrial sector microenterprises. The reason is that funding industrial sector micro-enterprises is much less attractive compared to funding tiny informal petty trade-based and handicraft microenterprises, mostly involving poor women and that can pay very high interest rates through the simple quick turnover activities they engage in. Moreover, in the manufacturing sector specifically, microenterprises now also dominate more than ever: 91% of Bolivia's manufacturing enterprises employ less than ten people, meaning few scale economies are being realised here (IDB 2010: 77).

An indication of the very serious *indirect* damage being inflicted on the Bolivian economy in this context comes from the aforementioned 'co-existence' scenario. In Bolivia, the World Bank's Enterprise Survey found that nearly 38% of all enterprises identified the practices of competitors in the informal sector as their most important business constraint (World Bank 2011a). Disaggregated by enterprise size, Vargas (2012: 11) points out that the informal sector represents by far the most serious obstacle for microenterprises and small enterprises in Bolivia (41.7% of such enterprises placed it as their main obstacle), the second most important obstacle for medium enterprises (25.8% compared to 27% for 'political instability'), and, surprisingly, by far the most important obstacle for large enterprises (59.1% of such enterprises placed it first). All told, these results led Vargas (2012: 23) to conclude that 'informality represents the most important obstacle for firms in Bolivia'. Clearly, the 'right' enterprises cannot develop and sustainably grow in Bolivia because they are increasingly forced to operate in a hostile sea of 'wrong' enterprises. Unfortunately, few researchers have chosen to register why and how this 'hostile sea' of informal enterprises has arisen, still less the obvious implications (opportunity cost), even though the evidence shows that the microfinance sector is clearly the principle driving factor.[14] Vargas (2012), for instance, in his otherwise comprehensive study of the issue, chooses not to comment on why it is that the informal sector in Bolivia has been given such a dramatic boost in recent years, to the extent that it seriously threatens the operations of the formal sector. Nor does Vargas choose to comment on the implications (opportunity cost) of the related fact that scarce financial resources are increasingly being withdrawn from supporting the formal sector, which he accepts is the most valuable sector from a development point of view, in order to fund the expansion of informal microenterprises.

In many respects the economic structure that has emerged in Bolivia this last twenty or so years represents a return to its pre-industrial (i.e., pre-ISI) past. With such a high percentage of Bolivia's financial resources now intermediated through the microfinance sector, and so into very low productivity informal microenterprises and one-person self-employment ventures, a very powerful 'anti-development' trajectory has clearly become embedded. Bolivia's natural resource wealth is not being invested into (re)building a more productive industrial economy, but into the construction of a Bangladesh-style informal microenterprise-dominated economic structure that past and present global experience shows is quite incapable of securing poverty reduction and sustainable bottom-up development. In addition, by unfairly displacing SMEs, and even large enterprises, that tend to respect societal obligations to pay taxes far more than informal microenterprises, one of the fundamental ingredients required to support poverty reduction – financial resources – is further denied to the government. The result is the reliance upon indirect taxation, the most anti-poor form of taxation.

All of the problematic issues just outlined help to explain why it is that resistance to the microfinance model in Bolivia is now growing fast. According to the former President of the Bolivian Chamber of Commerce, Enrique Velazco, thanks to the growing power and reach of the microfinance sector in Bolivia the Bolivian economy has gradually, but very thoroughly, been de-industrialized (Velazco 2012). This viewpoint is very much in accordance with the view held by the current Minister responsible for the Micro and SME sectors in Bolivia, who

[14] This form of cognitive dissonance is very common indeed. In early 2006, for example, the then Head of the World Bank in Bosnia, Dirk Reinermann, publicly expressed his deep concern over the size of the 'large and growing informal sector' and that it represented one of the 'key challenges in Bosnia and Herzegovina' (Press Release, World Bank, Sarajevo, March 2nd, 2006). However, Reinermann conspicuously overlooked the fact that the World Bank itself was pretty much the main driving force behind the rapid rise of the informal sector in Bosnia, thanks to its massive financial, regulatory and technical support for the microfinance sector. See also footnote 5.

also sees very serious drawbacks to the microfinance model and is as a result attempting to gradually restructure the financial system in order to make it more 'development-friendly'.[15]

Mexico

A similar destructive dynamic to the one in Bolivia has also arisen in Mexico in recent years, one that is also caused by the growing ubiquity of microfinance leading to a very rapid rise in the share of informal microenterprises and self-employed ventures in the economy. Under ISI policies, Mexico enjoyed some considerable success in promoting a growth-oriented SME sector. In the pivotal automobile sector, as Amsden reported (2001: 153-4), local content policies were able to build a flourishing supplier network in Mexico, one that had important wider technology and knowledge transfer impacts in the local economy, and was eventually capable of exporting on its own. However, this SME network was then undermined in the neoliberal years, among other things because funding became scarce and foreign assemblers were much more easily able to source from lower cost countries. Notably, Mexico's extensive '*maquiladora'* factories in the north of the country, once widely slated as containing the potential to industrialise the local economies they were based in, almost all failed to develop links with existing local SMEs or help establish new SMEs. Rather than prodding the maquiladora factories to begin to source locally, the neoliberal trade regime strongly encouraged them to make use of almost cost-free importation of raw materials and intermediate goods (see Zarsky/Gallagher 2004).

The generally deteriorating situation in Mexico was then exacerbated further in the 1990s thanks to the arrival of the microfinance model. This new form of financial intermediation very effectively began to shift Mexico's financial resources out of risky formal enterprise development applications comprising a high proportion of skilled workers, and into financing the expansion of the informal microenterprise sector that was mainly comprised of the surplus population abandoned by the shrinking formal economy. One reflection of this trend is that commercial bank lending to formal SMEs fell in the new millennium, going from 60% of total lending down to 48% in just over six year (Dos Santos 2008). Predictably, and in spite of an inflow of foreign-owned banks and foreign capital, managers in the formal enterprise sector in Mexico also increasingly report that 'access to finance' is one of the important barriers to their operations (World Bank 2011c: 4).

The inevitable result is that the formal sector has shrunk just as the informal sector has exploded in Mexico alongside rising levels of poverty (Cypher/Delgado-Wise 2010). The principle reason for this, as Mexican economist Santiago Levy (2007) has long pointed out, is the informalisation and infantilisation trajectory that has become embedded in the Mexican economy, a trajectory that lies at the heart of Mexico's ongoing low productivity and low growth problems. A central problem, Levy argues, is that of, 'Over-employment and over-investment in small informal firms that under-exploit advantages of size, invest little in technology adoption and worker training.' Exacerbating this problem even further is the fact that Mexico's financial resources are also increasingly being directed into resolving the immediate consumption spending needs of the poor, effectively encouraging them to permanently engage with debt (Soederberg 2012). Also likely to make things even worse today is the fact that Mexico's smallest banks are now gearing up to move into the already over-saturated market for microloans to informal businesses, with the potential to push traditional MFIs even deeper into the consumption lending segment for which they are best suited.[16] We know that increased consumption spending undertaken at the expense of investment has been detrimental to growth and development in Latin America (French-Davis/Griffith-Jones 1995), as it is everywhere else (Beck et al. 2012), so this increasing emphasis on consumption spending is clearly a very negative development in Mexico.

[15] Author's discussions in La Paz with the Vice Minister for Micro and Small Enterprises, Martin Bazurco, 9th May, 2012.
[16] See 'Small banks target lending at Mexico's informal sector', *The European*, 13th March, 2012. http://www.the-european.eu/story-335/small-banks-target-lending-at-mexicos-informal-sector.html

These and other factors have helped to reverse much of the development progress made up to 1980 in Mexico in terms of formalising the labour force, and in promoting regulated wage labour and formal enterprises as opposed to simple no-growth ‘survivalist’ forms of self-employment and informal family business. On this, Oliveira and Roberts (1989) pointed out that in 1940 nearly 38% of the non-agricultural Mexican population was involved in petty enterprise activities, and that by 1980 this figure had been reduced to just over 23% thanks to ISI policies, but it rapidly shot up again under neoliberal policies that ended all forms of state support for industrial development and, we might add, as financial resources were more and more vectored into microfinance applications. The end result today, as Roberts (1991: 135) correctly predicted in the early 1990s would be the case, is that ‘as whole families become dependent upon informal employment, the circle of poverty and deprivation is likely to be more intense than in the past’.

Focusing specifically on Mexico’s manufacturing-industrial sector, we find that today it is widely seen as structurally weak, and also weakening further and fast. A good part of the reason for this is that most of Mexico’s manufacturing capacity is located within the tiniest and least efficient microenterprises: similar to Bolivia, 91% of Mexico’s registered manufacturing enterprises employ less than ten people (IDB 2010: 77). Moreover, the above data only considers enterprises operating from a fixed location. In fact, nearly 34% of the Mexican labour force is employed in mobile locations, with five million working as self-employed and six million employed in microenterprises employing fewer than five workers (ibid: 79-80). In Mexico, managers in informal enterprises also saw competition from the informal sector as a major problem, with both managers in small and medium enterprises rating it their most important barrier (World Bank 2011c).

In addition, one of the direct consequences of Mexico’s almost entirely unregulated market for microfinance is that interest rates are now stratospherically high, and they are quietly getting even higher. The poor are paying a very high price indeed for access to microcredit. This outcome is entirely contrary to what neoliberal policy-makers and neo-classical economists have always maintained would be the case. Essentially, private commercial banks have been given the market freedom to make stratospheric fortunes for their managers and shareholders by selling ultra-expensive microcredit to the poor at the bottom of the pyramid. For a time, much global attention was focused upon *Compartamos* and its 195% interest rates that directly underpinned the Wall Street-style salaries, bonuses and IPO windfalls self-awarded to senior managers and outside investors. However, it is now clear that some Mexican MFIs are quietly charging their poor clients even *higher* interest rates than this in order to maximise profits. For example, it was recently admitted that the Mexican MFI *Crediconfia* charges its poor clients around 229% interest rates on its microloans. Pointedly, this fact only came to light in 2012 when the US-based microfinance advocacy and investment body, ACCIÓN, bought a 9% stake in *Crediconfia* to add to its already sizeable ownership stake in *Compartamos*. Many analysts were left to wonder, as did the leading free market-oriented Mexican business magazine, *El Economista*, how immensely difficult life must be for those attempting to service such high interest rates on tiny business activities.[17]

Overall, one of the most powerful processes underway in Mexico this last thirty years or so is what is known as ‘*changarrisation*’, a reference to the massive proliferation of *changarros*, or tiny informal ‘mom and pop’ businesses (see Cevallos 2003). It is an adverse dynamic that was greatly underpinned by the ‘anti-development’ microfinance model that came to Mexico in the 1980s, and it is now very widely seen as deleterious to Mexico’s chances of developing/retaining an advanced industrial economy. If even the business elite-friendly and traditionally free market-oriented Mexico Employers Association has argued that Mexico’s current fixation with ‘changarros’ means that all of its previous industrialisation gains are

[17] See ‘Nuevas alianzas en microfinanzas: CrediConfía-Acción Internacional’, *El Economista*, 22nd November 2012. Accssessed January 25th, 2012 at http://eleconomista.com.mx/columnas/columna-invitada-valores/2012/11/22/nuevas-alianzas-microfinanzas-crediconfia-accion-intern

gradually being reversed and its scarce financial resources wasted,[18] then we know that the problem has been registered even by those in Mexican society most ideologically predisposed to reject it.

Colombia

In Colombia, a relatively well-developed SME sector emerged under ISI, thanks to strong subcontracting links with the large enterprise sector. However, the period of neoliberalism and free trade saw Colombia's large enterprise sector coming under threat from larger and more productive foreign companies. One way to deal with this foreign threat was also to look abroad, and turn to securing cheaper imported raw materials and intermediate inputs. The local SME sector thus saw demand for its products fall off. In Colombia's second city, Medellin, for example, economic development was initially built on coffee (production and export), mining, finance and construction, but by the 1950s Medellin had built up a huge textile industry and the city became known as 'the Manchester of Latin America'. The textile industry was very adept at making links to the local economy, and networks and clusters of SMEs arose to service the requirements of the textile enterprises. During the neoliberal period, however, many of these gains began to disappear as much easier importation of raw materials and intermediate inputs became more feasible. There was then a major shake-out of SMEs in the city, most of which did not have access to affordable capital and technology, or low labour costs, required to compete with the main global suppliers of such inputs. As a result, the formal SME sector has shrunk considerably and the informal microenterprise sector now constitutes a very much larger part of the economy of the city of Medellin (Bateman/Duran Ortíz/Sinković 2011).

Over the neoliberal period the formal SME sector right across Colombia was increasingly displaced by the informal sector, with the informal economy peaking in 2000 at its highest ever level of 52% of the employed population (Florez 2002: 38). After 2000, the overall figure began to decline in line with Colombia's favourable economic performance, particularly its export performance. In urban areas, for instance, the percentage of informal workers fell from 47.2% in 2002 to 44.9% in 2006 (ECLAC 2008). But the gradual improvement pretty much stopped from 2008 onwards, as the global financial crisis began to bite hard, and as microfinance became more abundant than ever and used by those discarded from formal sector employment to establish a 'survivalist' informal microenterprise. By mid-2010, just over 52% of Colombia's employed non-agricultural population was working in the informal sector (ILO 2012).

In recent years, therefore, Colombia's economic structure has been restructured in favour of providing far more support for informal microenterprises and self-employment ventures, and this has directly underpinned a boom in their numbers. Related to this expansion is the resulting shortage of financial resources for formal small and medium enterprises, which have both contracted and exited the market. Colombia's small formal enterprises today find access to finance to be by far the most important barrier to their operations, as the Worlds Bank's Enterprise Surveys demonstrate (World Bank 2011b: 4). This is an extremely adverse development for a number of reasons. One, as Eslava et al. (2009) outline, is that small and, to a lesser extent, medium enterprises in Colombia have very much potential to raise their productivity, but simply cannot do so because of their limited access to financial support. This is, yet again, a very clear case of sub-optimal financial intermediation; a case where the 'good' enterprises are starved while the 'bad' enterprises are stuffed with as much capital as they can be encouraged to take on. In addition, there is yet again the familiar unfair competition aspect that arises from having such a large informal sector, with its ability to cut corners in terms of wages, taxes, social contributions and so on, allowing it to unfairly outcompete the formal enterprise sector that enjoy no such 'benefits'. The World Bank's

[18] Quoted in Cevallos 2003.

Enterprise Surveys confirm that this is seen as an important barrier to the success of the formal enterprise sector in Colombia, especially for medium-sized enterprises (World Bank 2011b).

Peru

Peru came late to ISI policy, initially preferring a natural resources-led development strategy in the post-war period. This delay partly accounts for the relative weakness of Peru's industrial sector and also its export performance (Dancourt 1999). In spite of some attempts to introduce industrial development programs in the 1970s and 1980s, some of which showed promise, the 1990s government of President Fujimori saw a quick return to a primary export-led development model within a neoliberal policy framework. The unfortunate result was a very rapid decline in the strength of Peru's industrial structure, and many industrial sectors disappeared. Economic growth recovered into the 1990s, but manufacturing output was still down 20% compared to before (ibid: 54).

In line with the reluctance to support an industrialisation strategy, from the 1980s onwards the structure of Peru's enterprise sector began to change markedly in the direction of increased informality, lower size and more simplicity. There is now a very large informal microenterprise sector in Peru, with in 2009 nearly 50% of non-agricultural persons found to be employed in the informal economy (ILO 2012). As everywhere else, Peru's informal sector is also characterised by extremely low productivity levels.

Regarding the SME sector in Peru, it accords to the Latin American norm in almost all respects: that is, it is very extensive, but fundamentally very weak and also mainly composed of enterprises operating informally (over 80% of new small enterprise starts do not register) and which are at the very bottom of the size category in terms of employees (Díaz/Jaramillo 2009: World Bank 2011d). Furthermore, it is widely recognised that because of the structure of the financial sector, promoting technology-based SMEs in Peru has become a very difficult task indeed. Increasingly, the financial sector is geared up to supporting informal microenterprises and so, by the same token, it is also losing what little interest it previously had in supporting riskier technology-based enterprises. In spite of abundant liquidity associated with a rapidly growing economy, surveys show that the commercial banks today continue to take a very conservative approach to financing SME development, especially with regard to risky new technologies (for example, see Zavata 2008). Yet, at the very same time, as we have seen, the financial system takes a very liberal approach when it comes to highly profitable lending to informal microenterprises. And until recently,[19] the Peruvian government was relatively sanguine about the fact that Peru's recent strong growth record has clearly encouraged, and at the same time has been underpinned by, the rapid expansion of consumer loans.

Thanks to both trends, Peru now ranks as one of the very worst performers in Latin America not just in terms of the overall weakness of its SME sector, but specifically also in terms of the technological content of its export sector (incorporating all sizes of enterprise), with an almost *halving* of the share of high-technology exports as a percentage of the total exports registered in the last ten years alone (IDB 2010: 240). It is also important to note that, as elsewhere, the microfinance-induced rise of the informal sector in Peru is widely seen as having a major deleterious impact upon the functioning of the formal enterprise sector. Just as in Bolivia, in fact, Peruvian managers consulted by the World Bank (World Bank 2011d) rated competition from the informal sector as by far the most important barrier to their

[19] Recently the Peruvian government has been forced to act in the face of continuing rapid growth in consumer loans - outstanding consumer loans taken out in US dollars rose 21% in July 2012 from a year ago – demanding the commercial banks abide by higher reserve requirements. See 'Peru keeps rate unchanged at 4.25% after damping credit growth, *Bloomberg*, September 7th, 2012.

successful operation and growth, with small firms appearing to be *most* negatively impacted by the presence of a sizeable informal sector.

Across the four countries briefly considered here, then, we find the microfinance model to be associated with a number of problems that are very much in line with the 'anti-development' model outlined in this article. The arrival of microfinance in these four countries in Latin America has encouraged the most unproductive enterprises to flourish at the direct expense of the more productive, which were denied resources that might have underpinned their success. The microfinance model has thus played a role in effectively precluding the most efficient local economic and social development trajectories from emerging: on the contrary, thanks to the expansion and operations of the microfinance industry, the local economies in all four countries studied are being studiously assisted to de-industrialise, infantilise and informalise. Before I move on in Section 8 to the policy response to such adverse local economic trajectories, I want to highlight some very important work by the Inter-American Development Bank (IDB) that is very much in line with the 'anti-development' model discussed here.

7. The Inter-American Development Bank (IDB) implicitly concurs with the 'anti-development' model outlined here

Recently, an astonishing case against the microfinance model in Latin America has been put forward by a very unexpected body – the neoliberal-oriented Inter-American Development Bank (IDB). The IDB's argument against microfinance is, for sure, indirect, but it is nevertheless extremely powerful and far-reaching. It emerged in the shape of the IDB's 2010 flagship publication *The Age of Productivity: Transforming Economies from the Bottom Up* (IDB 2010). Using data from right across Latin America, including specially commissioned data collection exercises and papers, the IDB has effectively blown out of the water the case for microfinance. In a nutshell, the IDB's view is as follows: for a long time (at least until the late 1990s) Latin America was trapped in poverty and under-development because it channelled far too much of its scarce financial resources into low-productivity informal microenterprises and self-employment ventures, and far too little into more productive formal small, medium and large enterprises. The IDB discusses this inefficiency very graphically, noting that the last twenty years has seen nothing more than 'the pulverisation of economic activity into millions of tiny enterprises with low productivity' (ibid: 6). The case studies contained in the volume repeatedly demonstrate that 'when credit is granted to unproductive enterprises, it perpetuates the misallocation of effort, work, and capital that reduces a country's productivity' (ibid: 9). That informal microenterprises and self-employment ventures are by far the most inefficient enterprise structures is fully accepted by the IDB, and that it leads to a very negative outcome, because 'resources are locked up in very small – often one-person – firms, of very low productivity' (ibid: 69). The IDB repeatedly denounces the role played by informality, which all too often ends up 'shielding small firms – the vast majority of which are very inefficient – from the competition of better, more productive business models' (ibid: 67).

Crucially, the low level of technology deployed in local economies right across Latin America is one of the most important outcomes of the destructive 'anti-development' processes described here. We know that informal microenterprises and self-employment ventures mainly involved in simple trade have, compared to formal SMEs and clusters of them, historically played an almost zero role in stimulating Schumpeterian-style industrial upgrading processes, improving the all-round level of technology and promoting innovation (Oyelaran-Oyeyinka/McCormick 2007). Does the IDB concur on this too? Indeed it does. It maintains (IDB 2010: 243) that one of the most unsatisfactory end results of neoliberal/Washington consensus policies was that it programmatically 'le(ft) the efficient allocation of resources among sectors to market forces (thus) closing out most of the room for any consideration of overall innovation strategy or selection of sectors'. This far-reaching conclusion leaves the door open for the IDB to recommend the return of industrial policy in Latin America, in the form of what it calls Productive Development Policies (PDPs).

However, even if the IDB makes a strong case against channeling finance into low productivity micro enterprises, it avoids making a direct head-on case against microfinance as such, even though the evidence for this is simply overwhelming. It is as if the massive expansion in the numbers of informal microenterprise and self-employment ventures has taken place in a vacuum and, among other things, the obvious resource implications (opportunity cost) of this historic expansion have no bearing whatsoever on, for example, the desperate search for more financial resources to support the most productive enterprises.[20]

The IDB's '*Age of Productivity*' study puts forward a very powerful argument along broadly the same lines as the contention put forward in this article (see Bateman 2010: see also Bateman/Chang 2012), which is that the (microfinance-induced) proliferation of informal microenterprises and self-employment ventures that has taken place in Latin America since the 1990s is one of the root causes of that continent's economic and social malaise. The proliferation of ultra-low productivity informal microenterprises in Latin America constitutes the worst possible enterprise foundation for sustainable growth, while simultaneously absorbing to no good purpose – thanks, for example, to displacement and exit factors – the scarce financial resources that would be better spent on constructing the enterprise foundation that *is* most associated with sustainable growth. Such is the destruction wrought across the continent that the IDB is forced into a quite radical conclusion (ibid: 6), one that holds that '(T)he overwhelming presence of small companies and self-employed workers (in Latin America) is a sign of *failure*, not of *success*' (my italics).

8. The need for a local industrial policy response in Latin America

If microfinance is not the proximate answer to the urgent need to promote sustainable local economic development in Latin America, then what is? A partial answer to this question comes in the form of the growing recognition in Latin America that there is an urgent need to introduce a new generation of industrial policies, including at the local level. This recognition arises for a number of reasons. First, it is not least thanks to the recognition that, as just outlined, an 'anti-development' de-industrialisation trajectory is underway in Latin America and that it must be halted as soon as possible. Second, the manifest success of industrial policies in several Latin American countries, notably in Brazil and Chile, have given many other Latin American countries the confidence, insights and specialist knowledge to begin to experiment with their own local versions.

Finally, it is also now becoming clear that the international development community's gift to Latin America of rafts of market-driven local development institutions, for a long time one of the main activities of the international development community all over the developing world, has turned decidedly sour. The most notable example of such failure in Latin America is with regard to the UNDPs (United Nations Development Program) long-standing support for a network of Local Economic Development Agencies (LEDAs). For a long time claimed to be making a major contribution to the economic development of local communities right across the continent (Milio 2009; Canzanelli 2010),[21] a recent independent study undertaken for

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[20] Interestingly, there are indications that at least some analysts within the IDB fully realised that the book made a very serious case against the microfinance model, and they were none too happy about it. According to one confidential informant attached to the IDB (personal communication December 2012), by mid-2011 an argument had broken out in the IDB, pitting the group responsible for the book against those within IDB at senior management levels and within the department responsible for microfinance programs.

[21] Almost unbelievably, prior to the 2012 impact evaluation of the UNDP's LEDA programs by Bateman, all previous evaluations were undertaken by the same small group of individuals who helped to design and establish the LEDAs, who 'sold' UNDP on the core idea that 'full cost recovery' had to be the guiding principle for the LEDAs, and who for many years thereafter provided consulting advice to UNDP with regards to the management and expansion of the LEDA program (one

UNDP by the author (see Bateman 2012b) found that the reality on the ground is actually very different. Problems abound with the LEDA model in Latin America (as elsewhere around the world – see Bateman 2000, 2005), but particularly with regard to the core ideologically-driven requirement that a LEDA must always be structured to achieve financial self-sustainability through 'earning its keep on the market'.

The most worrying outcome of Bateman's 2012 study, however, was that the very *worst* outcomes were registered in the one country – Colombia – where the LEDA network was otherwise judged by previous internal UNDP evaluations to be the best-performing in *all* of Latin America (for example, Canzanelli 2011). Indeed, Colombia's LEDA network has actually been widely promoted around the world by UNDP as *the* 'role model' LEDA network that all other countries should follow. This uplifting assessment on the part of UNDP emerged in spite of the central findings of Bateman's 2012 study in Colombia clearly showing that: with one exception, Colombia's LEDAs were financially unsustainable; the LEDAs generated almost no additionality, because they simply competed with other local development institutions and Universities for the very same projects and clients; the LEDAs were unable to meaningfully promote public-private dialogue, because they competed with most key public-private stakeholders for the same contracts; and, finally, the one and only LEDA in Colombia that proved successful in raising funds by charging user fees and obtaining consulting contracts after competitive tender procedures, was on course to be privatised by its managers in the near future for that very reason.

Leaving aside such apparently misguided international donor-driven initiatives, much progress is nevertheless already well underway in Latin America in terms of establishing effective local economic development trajectories thanks to pro-active local, city and regional governments. Indeed, even under the long-standing neoliberal/Washington Consensus policy regime, many localities, cities and regions in Latin America had taken the opportunity to begin to build the required local capacities needed to successfully implement a local industrial policy. But since 2000, various decentralised measures are really beginning to pay development dividends. In Ecuador, for instance, the city government in Quito funds a powerful local economic development body, CONQUITO (*Agencia Metropolitana de Promoción Económicá CONQUITO),* that is successfully supporting the city's business sector and entrepreneurs to carefully move into completely new areas of business, such as IT. New SME sectors have been created and training and skills development for new emerging sectors strengthened and extended. Institution development has also been an important aspect of CONQUITO's activities. For instance, local farmers have been connected to urban markets through farmer-cooperatives, which now supply much of the fresh agricultural produce to Quito. Pointedly, CONQUITO is a member of the UNDP network of LEDAs referred to above. However, given that it operates quite unlike the standard market-driven LEDA model promoted by UNDP, it is clearly a dissident member of the UNDP network. That is, CONQUITO is very much a development focused rather than self-sustainability focused body, it effectively works as an arm of the city government and is incorporated within its development planning functions, and, crucially, it enjoys a secure funding stream from the city government (and others) which it uses to relatively unproblematically fulfil the broad range of development tasks set for it.

Another interesting organisation is in Ecuador's southern city of Cuenca. Here the Azuay Provincial Government's economic development department has also achieved notable success in promoting new industries, institutions and industrial supply chains, especially involving the dominant industry in the region – agriculture. One such project is *Lac Jubones*, a dairy processing plant capitalised by $1 million obtained from the Provincial government. It is 51% owned by the Provincial government, and 49% owned by a cooperative ('*Jiron*')

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obvious example is Canzanelli 2011). Such a scenario of self-interest is guaranteed not to produce an un-biased and genuine evaluation of the suitability and real impact of the LEDA model.

composed of some 1,200 individual small farmers.[22] In just its first year of operation, *Lac Jubones* became the number two dairy processor on the regional market with contracts to supply dairy products obtained with several of the most important supermarkets in the Province and in Ecuador. Based on the rapid success of '*Lac Jubones'*, the Provincial government has now established 'Agro Azuay' to work in the area of fresh fruit and vegetables along exactly the same cooperative lines.[23]

In spite of a neoliberal/right wing central government, Colombia has also become something of a test-bed for local industrial policy, notably in the northern city of Medellin. Otherwise known as 'social urbanism', the city of Medellin has pioneered many interesting concepts within a distinctive local industrial policy framework. Taking a leaf out of Chile's book, the city of Medellin has, first, been able to fund many of its projects thanks to municipality ownership of a major company in the city – *Empresas Publicas de Medellín* (EPM) – which is mandated to channel 30% of its net annual profit into the city administration's budget. This financial bounty gives the city the fiscal space to engage in long-term development projects. Second, the city has established a network of fourteen publicly-funded *Centros de Desarrollo Empresarial Zonal* (CEDEZO). These are business support centres designed to offer special support to a range of business projects, especially among the poorest populations. Flexibility was vital here, since it was necessary to learn from mistakes and immediately correct them. The CEDEZO network, and its companion financial institution, the *Banco des las Opportunidades,* were together found to be producing mainly informal microenterprises, the bulk of which were short-lived and, even when they survived, they simply took clients from other struggling microenterprises, thus realising few *net* job or income gains (Bateman/Duran Ortíz/Sinković 2011). As a result, both institutions are currently being restructured to target support for more sustainable industrial and service businesses.

Finally, Brazil's well-known industrial policy successes at the national level, such as through its high-profile development bank, BNDES, are now being understood and followed right across the developing world.[24] What is less known is that Brazil's local communities have also been rediscovering the importance of local economic development and local institutions. For example, progress in new small enterprise creation and expansion has been very usefully underpinned by networks of community-owned Community Development Banks (CDBs). The CDB network provides funding on very affordable terms and maturities to individuals and groups with a solid business plan and an intention to remain local and to employ local people. With a network of fifty two CDBs across Brazil by 2001, there is now very real support for sustainable industrial businesses that can link into the largest enterprises as suppliers. The initial financial resources behind the CDBs came from local savings deposits. In later years, however, when it was recognised that larger enterprises would require larger loans, a number of tie-ups with much larger banks were forged – notably with *Banco Popular do Brasil*, the *Caixa Econômica Federal*, and with BNDES. This allowed the CDBs to access the resources to underwrite much larger enterprise development loans.[25]

These are just some of the very many examples of local industrial policy that are remerging after many years of enforced free market policies and the minimisation of all state activity. Of course, it remains to be seen whether or not the damage inflicted upon so many Latin American countries this last thirty years thanks to neoliberalism, and specifically thanks to microfinance, can ever be fully repaired at the local level.

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[22] It is planned that, once the initiative is fully established, the 51% of the shares in 'Lac Jubones' owned by the Provincial government will be passed over to 'Jiron' at a fair price.

[23] Interviews with Antonio Torres and Gustavo Flores, Economic Development Director and 'Lac Jubones' Project Economist, Azuay Provincial Government Economic Department, Cuenca, May 2nd 2012.

[24] BNDES has almost uniquely provided the driving force behind that country's recent economic miracle. It did this by judiciously supporting key large enterprises (famously such as the aircraft maker Embraer), but also the SME sector, both directly with affordable loans and indirectly through the very extensive use of local content agreements attached to its large company investments. BNDES is now the 'best practice' development bank that other developing countries are flocking to examine (e.g., see Timm 2011).

[25] SENAES (*Secretaria Nacional de Economia Solidária, Brasilia).*

9. Conclusion

The microfinance model has been celebrated since its arrival in Latin America in the 1970s. However, this article asserts that microfinance has, directly and indirectly, and in spite of some positive counter-aspects, played a major deleterious role in Latin America's economic and social development. It has done this by helping de-industrialise, infantilise and informalise the local economic structure. The microfinance sector has given rise to a particularly damaging financial intermediation process, one that supports the 'wrong' type of enterprises and avoids supporting the 'right' type of enterprises, and, even worse, where the 'wrong' enterprise directly displaces the 'right' type of enterprise through unfair competition. This adverse dynamic has been deeply damaging in Latin America, as elsewhere, and it lies at the heart of the long-term structural damage being inflicted by the microfinance model on Latin America's economies. Generalised poverty reduction and 'bottom-up' economic and social development trajectories have not only failed to emerge in Latin America thanks to the microfinance model – there is growing agreement on this today – but have actually been undermined and destroyed. As the formal sector contracts in Latin America as a result of the global financial crisis, and as the new default option for abandoned workers is an informal microenterprise helped into being by microfinance and crammed into an already over-crowded market space, there is little chance of any improvement soon. Pushing more and more surplus workers into the same depressed informal economic space has no real economic development or anti-poverty justification, still less any ethical content. On the basis of its own evidence base and analysis, the IDB implicitly concurs with the line of argument made here. One result is that new forms of local industrial policy are emerging right across Latin America, at least partly as the direct replacement for the now discredited microfinance model.

Finally, even though the damage inflicted by the microfinance model in Latin America is now being much more openly discussed and increasingly accepted, how come there is still real reluctance to make widespread changes? There is a long tradition within development that ideology and politics *really* drive the design and longevity of economic development interventions far more than whether or not they actually work (George/Sabelli 1994). In spite of all indications that it is having a negative impact on the poor, the microfinance model still has enormous political serviceability to the (now failing) neoliberal project, ostensibly validating the totemic neoliberal concepts of self-help and individual entrepreneurship. It is therefore not too difficult to conclude that this factor provides an important rationale for the continuation of the microfinance project. But one further explanatory factor also carries an increasingly significant weight in Latin America, as elsewhere (Sinclair 2012), which is the huge personal financial reward being enjoyed by so many working in, and close to, the microfinance sector. The *Compartamos* scandal raised above, and other similar unethical episodes in Mexico, and also in Bolivia, Nicaragua and elsewhere in Latin America, strongly suggest that the microfinance model has become a personal enrichment vehicle of the very first order. My final point would therefore be to argue that the 'age of microfinance' can now be much better described as Latin America's own sub-prime financial episode, an episode that, very much as per the original US-based version (see Dymski 2009), has materially benefitted a tiny elite working within and around the microfinance sector whilst simultaneously destroying many of the most important pillars of the local economy and society. This is probably not what the pioneers of microfinance had in mind back in the 1970s when they came to work in Latin America, but it is what appears to have transpired nonetheless.

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