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South Africa's post-apartheid microcredit-driven calamity: Comparing 'developmental' to 'anti-developmental' local financial models

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List of Abbrevations

ADB	Asian Development Bank
AfDB	African Development Bank
AMCU	Association of Mineworkers and Construction Union
ANC	African National Congress
CEO	Chief Executive Officer
CGAP	Consultative Group to Assist the Poor
CLP	Caja Laboral Popular
DFID	Department for International Development
IDB	Inter-American Development Bank
ILO	International Labour Organization
IPO	Initial Public Offering
ISI	Import Substitution Industrialisation
MCIs	Microcredit Institutions
NCA	National Credit Act
NCR	National Credit Register
NUM	National Union of Mineworkers
RCCs	Rural Credit Cooperatives
SCIs	Special Credit Institutes
SEF	Small Enterprise Foundation
SEFA	Small Enterprise Finance Agency
SME	Small and Medium Enterprises
TVEs	Township and Village Enterprises
UCCs	Urban Credit Cooperatives

Abstract

Microcredit was once universally lauded in international development community circles as a ‘magic bullet’. Using the example of South Africa, this paper shows that microcredit has actually been an ‘anti-developmental’ local financial model, and one of the most calamitous financial sector interventions in South Africa’s short post-apartheid history. This disastrous performance is compared to a benchmark local financial model that I call the ‘developmental’ local financial model, a financial model that was quite decisive to much recent European and Asian local economic development success. Overall, microcredit can be viewed as South Africa’s own sub-prime-style disaster which, like the original US version, has mainly served to benefit a tiny financial elite working within and around the microcredit sector, whilst simultaneously destroying many of the most important pillars of the economy and society. It clearly behoves policymakers in South Africa, as well as policymakers in other African countries and elsewhere in the international development community, to learn from South Africa’s negative experience with ‘anti-developmental’ microcredit to date and promote alternative ‘developmental’ local financial models.

JEL Codes: G2, H7, O2,O4,

Keywords: Microcredit, South Africa, impact, poverty, informal, SME, institutions.

1. Introduction

Thirty years ago, the international development community was abuzz with excitement. The reason was that the almost perfect solution to poverty, unemployment, inequality and low growth in developing countries, including in Africa, appeared to have been finally located. This solution was *microcredit*. As originally conceived, microcredit is the provision of tiny micro-loans to the poor to allow them to establish a range of income-generating activities, thereby helping them to supposedly escape poverty.[1] A widespread assumption quickly emerged suggesting that the microcredit model would, among other things, generate significant local employment opportunities, raise average incomes, empower women in poverty and assist them to escape their predicament, reduce inequality as the poor were more fully included in productive economic activities, and so, overall, create the basic foundation for sustainable 'bottom-up' local economic and social development. Not surprisingly, given such assumed benefits, microcredit was incorporated into the international development community's array of local development policies and programs, ultimately becoming the most important international development policy of all.

South Africa is one of the many developing countries that has opted to very seriously engage with the microcredit model. Even before the end of the apartheid system the microcredit model was receiving support from the international donor community to set up new institutions. But the end of apartheid predictably gave this effort an enormous fillip. Thanks to international development community financial, technical and political support for microcredit programs and policy development, several new MCIs were established and some existing MCIs expanded. But even more important were changes to the South African financial system that greatly encouraged a wider variety of institutions, especially private commercial banks, to 'downscale' into what were quickly turned into hugely profitable microcredit operations. As a result of the rapidly increasing supply of microcredit, many microcredit advocates began to argue that South Africa's poor black majority would soon be enjoying an historically unprecedented 'bottom-up' self-help-led positive transformation in their lives and communities. And even though in the years after the end of apartheid researchers could find no solid evidence to show that anything remotely like this uplifting scenario was actually taking place (for example, see Stewart et al. 2011), this did not appear to matter. Until relatively recently at least, virtually all sections of South Africa's political and business community, as well as the international development community, continued to celebrate the microcredit model as one of the most successful of the many post-apartheid policy initiatives.

This paper takes a completely different tack. I centrally argue here that the evidence in South Africa unequivocally shows the microcredit model to have been one of the most calamitous policy and program interventions in the post-apartheid era. Today, as in many other developing countries (see below), the sheer precariousness of the microcredit model is even beginning to threaten the very foundations of South Africa's financial system. My specific arguments here will particularly emphasise, firstly, the microcredit model's deleterious impact on the evolving structure of the average local economy in South Africa. Rather than microcredit having produced large numbers of flourishing growth-oriented local economic spaces, we see instead the programmed de-industrialisation, informalisation, disconnection, and primitivisation of the local economy. That is, those local economies most exposed to microcredit have effectively been 'dumbed down' and now find themselves caught in a poverty trap of their own making. I also go on to note that the long-term impact of the microcredit model on social institutions and individuals is equally negative, further

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

destroying post-apartheid South Africa's already thin reserves of intra- and inter-ethnic community trust, mutuality, reciprocity and solidarity. In the very worst case scenario, the market-driven microcredit model has directly, and knowingly, helped to create the conditions that eventually precipitated physical violence.

The paper begins in the next section by providing some necessary background to the global rise and recent fall of microcredit. I start by outlining the microcredit model's origins and initial supposed successes, before I then briefly document the key evidence points showing that microcredit has actually been doing far more harm than good in poor local communities. To aid the analysis, section 3 briefly outlines what I call a 'developmental' local financial model, one that is built upon the key insights and experiences arising in a variety of countries and regions that, not unlike in the case of South Africa, have undergone a major transition from one economic and/or political system to another. This simple model is the obvious counterpart to the 'anti-developmental' microcredit model discussed in section 2, and which has taken root in South Africa since 1994. In section 4, I then turn to the experience of South Africa itself. I briefly point out that the early experience of the microcredit model was less than encouraging, if not an outright disaster, but the microcredit model was persisted with nevertheless. Section 5 then goes on to summarise the key areas where the microcredit model has served to seriously undermine local economic and social development progress in the post-apartheid era. Many other key issues raised are familiar to other countries and localities now also experiencing their own problems with microcredit, but I try to bring out the particular South African features of what is clearly emerging as a microcredit-driven debacle. Finally, in section 6, I recount one of the most recent developments in South Africa and how it links the microcredit model to extreme exploitation, over-indebtedness and desperation, conditions that then, arguably, gave rise to the outbreak of the most violent episode since the post-apartheid era began – the Marikana Massacre that took place on August 16th, 2012, claiming the lives of 34 demonstrating miners.

2. Background to the microcredit model

As is well known, the microcredit model is most closely associated with the US-educated Bangladeshi economist and 2006 Nobel Peace Prize winner, Dr Muhammad Yunus, and his work in the village of Jobra in Bangladesh in the 1970s. Famously lending $27 out of his own pocket to 42 women in Jobra, with the money being promptly returned in full, Yunus conceived of a new way for the poor to escape their poverty en masse; by encouraging every last one of them to access a micro-loan and get involved in simple informal income-generating activities, such as petty trade, basket-making, home production, rickshaw driving, and so on. Although initially met with scepticism from his peers, who pointed out that most of Bangladesh's poor communities were *already* over-supplied with these simple products and services (Ahmad/Hossain 1984; Osmani 1989)[2], Yunus's uplifting message did not fall on deaf ears. On the contrary, many were listening. Not least because he took to grandiosely claiming that microcredit would 'eradicate poverty in a generation' and that children would have to go a 'poverty museum' to see what all the fuss was about, Yunus was soon being viewed both within and outside of Bangladesh as a major authority on poverty reduction. In 1983 Yunus was able to establish his own 'Bank for the Poor', termed the Grameen Bank

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

(Rural Bank in the local language), with funding largely coming from the US-based Ford Foundation.

Although not in possession of any concrete empirical evidence to confirm what he was saying,[3] and to the obvious annoyance of a number of reputable development economists at the time,[4] nonetheless Yunus was soon very widely proclaiming that the Grameen Bank was making a massive contribution to poverty reduction in Bangladesh. In due course Yunus began to receive invitations from the international development community to help promote microcredit around the developing world. Many other developing countries began to respond to Yunus's message by establishing rafts of their own microcredit institutions (hereafter MCIs) along Grameen Bank lines. Under the driving force of USAID and the World Bank, joined by the Inter-American Development Bank (IDB), the African Development Bank (AfDB), and the Asian Development Bank (ADB), financial, technical and political support for the microcredit model was massively stepped-up right around the world.

Importantly, and once again led by USAID and the World Bank, steps were taken in the late 1980s to fully commercialise (one might say 'neoliberalise' – Bateman 2010a) the microcredit model. This new direction was taken in order to ensure that microcredit would conform to the standard neoliberal imperative known as 'full cost recovery', a concept that dogmatically specifies that no organisation should function in a market economy as anything other than a financially self-sustaining one. Continued reliance upon international donor and government subsidies was simply out of the question. In future, as two of the most impassioned commercialisation advocates, Maria Otero and Elisabeth Rhyne (1994), argued, MCIs should be expected to operate like any other for-profit organisation and 'earn their keep on the market'. In this 'new world' of commercialised microcredit, the profit motive would ensure that MCIs would soon be pumping out massive volumes of microcredit, thus ensuring that every last poor person could access a microloan if they wished. MCIs would achieve this important outreach goal thanks to several new market freedoms which were soon to become fundamental to the operation of almost all MCIs: the freedom to charge market-based interest rates, the freedom to incentivise staff with supposedly 'efficient' Wall Street-style salaries, bonuses and personal shareholdings in their own MCI (if not complete ownership of it), and the freedom to engage with the global investment community in order to obtain large volumes of additional wholesale funding. Meanwhile, the old Grameen Bank model of subsidised microcredit was quietly phased out almost everywhere. In 2001, Muhammad Yunus belatedly gave in to the mounting pressure and fear of being marginalised, and so took the required steps to convert the Grameen Bank itself over to for-profit commercial respectability (Hulme 2008).

By the early 2000s, the microcredit model had ascended to become the most high-profile and well-financed international development policy of all time. Summing up matters on behalf of the international development community, Bernd Balkenhol (2006), a senior ILO official then heading up its Social Finance Unit, described microcredit as "<u>the</u> strategy for poverty reduction *par excellence*" (underlining in the original). Others equally enamoured of microcredit's supposed power described it as "the vaccine for the pandemic of poverty" (Mackay 2006). Not least thanks to rafts of celebrity endorsements,[5] microcredit quickly

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[3] Later on, Yunus took to using the results of a major World Bank study on microcredit in Bangladesh (Pitt and Khandker 1998) to claim that '5 % of Grameen borrowers escape poverty every year'. However, this claim, and many of the other important impact claims made in Pitt and Khandker's hugely influential original study, were later shown by Roodman and Morduch (2013) and Duvendack and Palmer-Jones (2012) to be false. Notably, by dropping just 16 outlier rich families from Pitt and Khandker's sample of 5,218 families, Roodman and Morduch found that Pitt and Khandker's core 'positive poverty impact from microcredit' finding completely disappears. http://www.cgdev.org/blog/bimodality-wild-latest-pitt-khandker (May 25th, 2014).

[4] For example, noted development economist, David Hulme (2008; 6), has written that Yunus "energetically promoted microenterprise credit as a panacea for poverty reduction (something that intensely annoyed me, as it was so wrong)".

[5] High-profile supporters of microcredit come from Hollywood (Natalie Portman, Matt Damon), high-profile political families (most notably Bill and Hilary Clinton), the music industry (Bono), entrepreneurs (Bill Gates through his foundation, Richard

became the one international development policy that most ordinary members of the public had actually heard of and – crucially – very much liked.[6] Muhammad Yunus was even invited to participate in an episode of *The Simpsons*.[7]

But always carefully hidden behind the obvious PR and heady celebration were the important political and ideological goals espoused by those supporting the microcredit industry. Above all, thanks to the arrival of microcredit and through self-help and self-employment, the poor could now be forcibly repositioned into accepting that they were once more *individually* responsible for lifting themselves and their families out of poverty. The poor need no longer reject capitalism and militate for some alternative to it, or protest or take up arms against its main beneficiaries, because it can now work for them too: *they can now get their own small 'piece of the actio*n'. This was the supremely ideological 'bringing capitalism down to the poor' message that began to be pushed out by the growing number of high-profile neoliberals and neoliberal-oriented international development institutions that became the most dedicated supporters of the microcredit model. One of the most notable early supporters of microcredit, for example, was arch-neoliberal Hernando de Soto (1986). De Soto famously claimed that the poor were all 'entrepreneurs in waiting' and that thanks to extensive deregulation and more microcredit their poverty would very quickly come to an end. Alongside Muhammad Yunus's tireless promotion of the microcredit model, De Soto's similarly uplifting (though ultimately quite mistaken[8]) message to the poor was to prove hugely influential in shaping the view of the international development community on the right way to address poverty. The overall result, as the world leading social geographer, David Harvey (2014: 186), pointedly concluded, was that the international development community had wrongfully bought into,

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

In a return to brutal pre-modern times, escaping poverty was now once again all down to the poor individual herself, and not to state agency and the exercise of collective capabilities that, free market rhetoric and neoliberal mythology aside, actually mark out all of the most successful economic development and poverty reduction episodes in modern history (Chang 2002). Business and political elites could now rest easy in their self-serving belief that nothing else need be done to assist the poor.

But then hubris turns to nemesis.

Starting in 2007, however, the microcredit industry was rocked by a quick succession of body blows that combined to destroy pretty much the entire case that had been carefully built up in its favour. In this year we saw the first, and perhaps most damaging, of what was to become a whole series of financial scandals to erupt in the microcredit industry, scandals that appeared to perfectly illuminate the real purpose and impact of microcredit far more than

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Branson, Pierre Omidyar, Michael Dell) and European and Middle Eastern Royalty (Queen Rania of Jordan, Queen Maxima of Holland).

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

7 See '*Loan-a Lisa'*, The Simpsons, episode 466.

8 In De Soto's own Latin America, the informal microenterprise sector doubled in size over the 1990s, but so did poverty levels in almost exactly the same locations (see the discussion in Bateman 2013a). De Soto later equally famously went on to claim (De Soto 2000) that if the poor had individual title to their assets, they could access unlimited amounts of microcredit. Indeed, his native Peru went to evolve a more than $11 billion microcredit sector, the world's largest microcredit sector by value, but this growth was almost entirely a result of collateral-free lending mechanisms. Interestingly, as this paper is being written, Peru's vast microcredit sector stands on the verge of collapse – see below.

any uplifting economic theorising could do. This first scandal followed the now infamous Initial Public Offering (IPO) of Mexico's largest microcredit bank, Banco Compartamos. This was an event that was noteworthy not because it was able to demonstrate that poverty had been reduced in the community – there remains absolutely no proof of this whatsoever[9] – but because it exposed to the public spectacular profiteering by its own senior management and investors (Bateman 2010: 142-152), and even by the US-based advisors involved.[10] As a result of many more such scandals, the commercial microcredit model began to be challenged by its own long-time advocates, many of whom were becoming disillusioned by the hard-nosed Wall Street-types taking over the microcredit industry in search of wealth for themselves and their investors (Dichter/Harper 2007; Harper 2011; Sinclair 2012). The sour reality that has to be faced up to, as Harvey (2014) makes clear, is that microcredit has morphed into just another sophisticated technique, *but this time very much socially-validated*, of transferring value from the poorest individuals and communities into the hands of business and financial elites in society.

As the increasingly negative impacts of commercialised microcredit were being digested and responded to, elsewhere an attack was being made on the fundamental economic principles underpinning the microcredit model. Economists have been drawn to the fact that the link between local financial institutions and expansion of the informal sector remains under-researched (Beck/Lin/Ma 2011), a somewhat surprising fact given that (and very much thanks to microcredit) developing country economies are increasingly composed of simple unproductive 'buy cheap, sell dear' informal microenterprises.[11] In this context, many analysts have challenged certain operational aspects of the microcredit model in terms of it being mainly associated with pushing out informal 'survivalist' microenterprises (Rogaly 1996; Elyachar 2005). Others, however, began to mount a more fundamental challenge to the economic and social rationale for the microcredit model. According to this way of thinking, microcredit can be seen as an 'anti-development' policy, one that can only ever disadvantage the poor into the longer run by stunting local economic and social development (Bateman 2003, 2007a, 2010a, 2013a, 2013b, 2014; Chang 2010: 157-167; Bateman/Chang 2012).

Key issues raised here, among many, include the de-industrialising, informalising, disconnecting and primitivising effects of microcredit, as well as the major opportunity cost that arises when microcredit displaces, as it typically does, more productive forms of credit, such as SME credit. More fundamentally, as Rienert (2007) shows, any development strategy that is substantially based on a programmed expansion of diminishing returns activities, typified by the informal microenterprises and self-employment ventures supported by microcredit, must inexorably lead to retrogression and primitivization. Important scale economies are lost, technologies suitable at certain volumes of activity are entirely abandoned, important efficiency-enhancing vertical and horizontal inter-enterprise

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

10 In her position as President and CEO of Boston-based ACCIÓN, one of the main investors in Compartamos, it was Maria Otero's role to advise Compartamos officials in the run-up to their IPO. For her efforts, Otero was generously rewarded with a million dollar bonus in 2008, and then a further $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)

11 As are the developed country economies, too, thanks to the Great Recession (Fairlie 2013).

connections are inoperable, and many other similar problems arise. Disaster ultimately ensues, as history abundantly shows. As Reinert (2007: 171) sums up,

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

It is not by coincidence that this general primitivization and retrogression dynamic described by Reinert is *exactly* what we are seeing in all of those locations – national, regional and local – where the microcredit model has gained the strongest foothold (Bateman 2010a, 2013a).

Crucially, the emerging heterodox argument against microcredit soon began to receive quite decisive empirical support for its main contentions. This was thanks to the release of a number of careful studies that explored the methodological robustness of the long-standing positive impact claims made by the microcredit industry and its mainly US-based academic supporters. By far the most important of these outputs came in 2011, in the shape of a UK government-funded systematic review of all the accumulated impact evaluation evidence purporting to show a positive impact from microcredit (Duvendack et al. 2011). Although initially conceived by the UK government's aid arm, the Department for International Development (DFID), as a way of providing support for its microcredit programs, which were still being implemented in spite of the strong headwind of criticism, the review team actually made things much worse for DFID. This was because the review team could find no solid evidence whatsoever to support the many long-standing positive claims made on behalf of the microcredit model. Centrally, the evaluation team found that all the previous impact evaluations that came to broadly positive conclusions regarding microcredit, and which effectively gave life to the idea of microcredit as development policy, only did so because they were biased, incomplete, or else used completely inappropriate methodologies. The overarching conclusion of the systematic review was a major blow to the microcredit industry, and to DFID, claiming (ibid: 75) that the '*Current enthusiasm* (for microfinance) *is built on (..) foundations of sand*'.

Finally, and once again confirming the negative prognosis of heterodox economists, those countries and regions previously held up by the microcredit industry as the 'star performers', one by one began to collapse in an entirely predictable market-driven 'boom-to-bust' scenario. Starting first in pioneering Bolivia in 1999-2000, an event that microcredit advocates argued at the time was as a 'one-off' (Rhyne 2001), destructive 'boom-to-bust' scenarios then quite devastatingly played out from 2008-9 onwards in Nicaragua, Morocco and Pakistan (Schicks/Rosenburg 2011). Bosnia's massively celebrated microcredit sector encountered its own bust in 2009, just one indication of the serious economic and social damage associated with the microcredit model's establishment in that country (Bateman/Sinković/Škare 2012). In 2010 the microcredit industry was then convulsed by the largest and most destructive market-driven 'boom-to-bust' episode to date, in Andhra Pradesh state in India (Arunachalam 2011; Bateman 2012b).

At one time, the home of microcredit – Bangladesh – was also very rapidly heading towards the 'boom-to-bust' category. However, for reasons we are not yet clear about, it seems that sometime around 2010 the CEOs of the main MCIs in Bangladesh were encouraged to get together and they agreed to pull back from the edge (Chen/Rutherford 2013). Expansion plans were shelved, some MCIs pruned the number of units they had, and aggressive bonus systems primarily based on bringing in new clients were scaled down. Although Bangladesh's microcredit sector still remains in some considerable danger, thanks to its dramatic over-expansion prior to 2010, the genuine fears expressed only a few years ago of there being a total collapse in the market – 'a coming train wreck' as one leading MCI manager put it – have, for now anyway, abated.

Like Bangladesh, a number of other countries also stand on the precipice of a meltdown today. This list would certainly include Mexico (see Graham/Ericksen/Ericksen 2014; Rozas, 2014), but also Sri Lanka, Nigeria, Nepal, Kyrgyzstan, Georgia, Lebanon, Cambodia, Ghana, Uganda and Colombia. As I will show below, South Africa must be included in the category of countries at very serious risk of a 'microcredit meltdown'. Probably the leading candidate for a forthcoming 'boom-to-bust' scenario, however, appears to be Peru, a country where a simply staggering $11 billion of microloans have to date been disbursed among less than 4 million poor clients.[12] Crucially, it must be emphasized once again that in *none* of these country examples do we find any solid evidence whatsoever that poverty has been reduced as a result of the massive expansion in the supply of microcredit.

Although initially challenged by the microcredit industry, by 2013-4 almost all of the core arguments put forward by skeptics such as Bateman (2010a) and Bateman/Chang (2012), had been pretty much confirmed as valid and accurate.[13] It is thus no surprise, or over-statement, to say that the microcredit concept is today in an existential crisis (Bateman/Maclean forthcoming). This crisis has arisen because the microcredit model is infused with very many fundamental flaws, basic logical errors, manifest falsehoods, and is anyway driven by a carefully obscured political and ideological agenda. We should therefore not be surprised to find that there is no incontrovertible evidence to show that microcredit actually works as it is supposed to do. In fact, as Duvendack et al. (2011) concluded in their pioneering systematic review, we must look to the *political* rationale as to why there has been, and remains, so much support for the microcredit model.

3. Outlines of a 'developmental' local financial system

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

Economists have recently paid more attention to the financial system and its impact on growth and development. After a long time working under the assumption that the financial sector has little to do with economic growth, mainstream researchers in the 1990s began to challenge this view. Beginning with King and Levine (1993a, 1993b), a large literature emerged showing that the depth and breadth of the financial sector actually plays an important role in promoting growth and development. It does this by increasing the quantity of finance available for enterprise development and the quality of investments made thereafter. However, for many development economists, this interpretation was incomplete, at least partly because it failed to explain most actual historical episodes of rapid development and growth.

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12 For example, see Hugh Sinclair. 'What are some of the signs of a looming microfinance crisis?' 8th February 2014. http://blog.microfinancetransparency.com/what-are-some-of-the-signs-of-a-looming-microfinance-crisis/ (May 25th, 2014).

13 For example, in 2013 Dr Claus-Peter Zeitinger, one of the world's most respected microcredit pioneers and founder of the largest microfinance bank in the world, the Pro-Credit Bank Group, wrote in a review that he had had an epiphany when he read the author's book (Bateman 2010a) because it was such an accurate reflection of the many serious problems he (Zeitinger) had encountered in the nearly 30 years he had spent working in the microcredit industry. Bateman was then invited to the Pro-Credit Bank AGM in Frankfurt in May 2013 in order to give a keynote presentation in front of 200 Pro-Credit senior employees and then to debate with Dr Zeitinger as to why microcredit failed and what to do about it. Pro-Credit Bank also ordered 500 copies of Bateman's book for use as a teaching aid in their three training centres in Germany, Macedonia and Colombia. Pro-Credit Bank's future strategy is to fully exit the microcredit sector and establish itself as one of the most reputable banks providing quality financial services to the SME sector. See 'Why Doesn't Microfinance Work? The Destructive Rise of Local Neoliberalism' – Comments by Dr. Claus-Peter Zeitinger, initiator and founding shareholder of the ProCredit group', *Zed Books Blog*, 6th June 2013. http://zed-books.blogspot.com/2013/06/why-doesnt-microfinance-work_6.html (May 25th, 2014).

A number of heterodox development economics began to develop alternative ideas based on the notion that something else was going on here. They suggested that a *developmentally* efficient financial system is actually far removed from the type of market-driven financial system celebrated in neoclassical textbooks. A developmentally efficient financial system is one, moreover, that not just *increases* the quantity of capital available for investment in the enterprise sector, as such as King and Levine posited was important, but one that also possesses particular institutions, organisations and regulatory structures that are capable of 'guiding' that capital into the 'right' growth-oriented enterprises. Defining the institutions and organisations that can successfully 'guide' capital, and also what these 'right' enterprises were, formed much of the foundation of the seminal work of Johnson (1982), Amsden (1989, 2001, 2007), Wade (1990), Chang (1994, 2002, 2007, 2010), Evans (1995), Lall (1996) and Weiss (1998). A further important contribution in terms of defining the 'right' enterprises was also made by Nelson and Winter (1982) in their theory of evolutionary change. They showed that only particular types of enterprise drive growth and economic development, those big enough, flexible enough and sophisticated enough to be able to take part in a process of increasing technological and institutional capability-upgrading and continuous learning.

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

- are formally registered and operating according to all legal requirements
- are operating at, or well above, minimum efficient scale
- are as much as possible operating on the technology frontier
- are innovation and skills-driven rather than (just) low labour cost-driven
- are horizontally – clusters, networks – and vertically – sub-contracting, supply chains, public procurement – productively inter-connected with other organisations
- are able to continually facilitate the creation of new organisational routines and capabilities 2013ivate Sector Development.

Meanwhile, others working in the sub-field of local economic and enterprise development have also made important contributions in helping us to define what is a 'wrong' enterprise, one that we must avoid and not waste scarce funds in supporting. Of particular importance to the analysis here are those who have pointed out why informal microenterprises and self-employment ventures are 'anti-developmental' and growth-impeding. A notable contribution was made by Baumol (1990), who provided a useful typology of enterprises and entrepreneurship, including those forms that that he saw as ultimately destructive. Storey (1982, 1993, 1994) and Storey and Johnson (1987) provided substantial support for the argument that the process of new entry *per se* is efficiency-enhancing and justifiable on a cost-benefit basis, but generally *only* when this involves that small number of enterprises possessing growth-potential. Writing in the recession-hit UK of the late 1980s and early 1990s, Storey strongly argued against the then Thatcher government's policy of pushing the unemployed in generally already demand-constrained communities, and pointedly following major company shut-downs, to attempt to create their own jobs through self-employment and a micro-business. Among other things, such a policy led directly on to equally high exit rates, so that, in the main, virtually no NET permanent jobs were really created thanks to displacement (Hasluck 1990). Moreover, because many individuals lost long-held assets offered up as collateral after failing in their attempt to set up in business, such as housing, land, and motor vehicles, and pointedly including any redundancy monies they might have received prior to becoming self-employed, a large (but largely ignored) number of individuals unsuited towards entrepreneurship can be plunged into even deeper poverty, debt and insecurity than ever before. More recently, La Porta and Shleifer (2008) and Shane (2009) disproved the related myth that the informal microenterprise sector serves as the foundation, or 'breeding ground', for larger and higher productivity SMEs. Nightingale and Coad (2014) very usefully summarise some of the key issues raised by these and other authors, and conclude that "(A)cross the board policy enthusiasm for entrepreneurial start-ups, no matter their quality, might be seen as another policy fad." (ibid: 136).

We might roughly define the 'wrong' type of enterprises as those that:

- are typically simple microenterprises or one-person self-employment ventures,
- are unregistered or, worse, illegal
- are in possession of no functional links to other local enterprises (subcontracting, clustering) or to the community (e.g., taxation, adherence to health and safety legislation)
- are operating at below minimum efficient scale,
- are low/no technology-based,
- are driven more by low wages rather than innovation or skills upgrading,
- are in possession of almost no concern for the environment,
- are very often petty trade-based.

Combining the two concepts, we might usefully define a 'developmental' financial system as one that can most efficiently mobilise and channel scarce financial resources through to the 'right' enterprises, while avoiding wasteful support for the 'wrong' enterprises. Crucially, economic history shows a particularly strong causative link between <u>regions/localities</u> that have constructed just such an approximation to a 'developmental' financial system, and a subsequent sustainable and equitable economic and social development trajectory. It is increasingly accepted that in many parts of Europe, notably in Germany, France, Italy, Switzerland, and the Scandinavian states, as well in the USA and as post-war Japan, the <u>local</u> financial system has played an absolutely pivotal role in securing long-term local economic and industrial success. We then find that very similar local institutions were established in many parts of post-colonial Asia just prior to the explosive growth and major poverty reduction episodes that took place in one country after another. Here we have the real local alternative to the microcredit model.

Three actual institutions are of most importance in the 'developmental' local financial system. The first are well-functioning financial cooperatives and cooperative banks. From the mid-1800s onwards such financial institutions were typically established by individual social reformers, but then accorded legitimacy within the community once it was seen that it would operate to the benefit of that community. Examples include the cooperative banks of northern Italy, which have a long and distinguished history of supporting local economic development (Zamagni/Zamagni 2010). However, once restructured and re-capitalised after 1945, they went on to play a very decisive role indeed in rebuilding the region's SME-based industrial sector (Goglio/Alexopoulos 2011). In particular, important lessons can be learned from the individual region of Emilia Romagna. This was a once poor region that began to flourish in the post-war era largely thanks to patient cooperative bank support for a manufacturing-led SME development trajectory. The cooperative banks usefully built upon both the region's largely destroyed military-industrial complex (Capecchi 1990), and its long experience with cooperative enterprises, in the process creating the world's leading regional cluster of worker and other cooperatives (Bateman 2007a). Note in passing that although many of the traditional Milan and Turin-based big private banks recovered after the war, they were mainly (self-)interested in financing the lucrative consumer goods import trade on behalf of still relatively wealthy Italians, not in promoting long-term local economic development outcomes through careful support for the SME sector.

Germany effectively stands as the ‘home’ of cooperative banking, thanks to Hermann Schulze-Delitzsch and Friedrich Wilhelm Raiffeisen, both of whom pioneered differing versions of credit cooperatives that eventually became a bulwark in helping establish and sustain Germany’s small enterprises, especially the famous ‘*mittelstand*’ (medium-sized enterprises) (Harm 1992). Also efficiently serving the SME sector at the local level in post-war West Germany were the cooperatively-owned savings banks (*sparkasse*), which, likewise, proved to be very successful – *too* successful in fact[14] – in promoting a bottom-up industrial development trajectory based on small quality-based, technologically-savvy and innovative enterprises (Hakenes et al. 2014).

Spain provides two important examples of highly successful cooperative-based local financial systems: one famous, and the other much less so. The first is located in the Basque region of northern Spain. The *Caja Laboral Popular* (CLP) attached to the famous Mondragon Cooperative Complex has proved over 50 or more years to be a very successful promoter of manufacturing-based cooperative enterprises (Bateman/Girard/MacIntyre 2006). Such is its diligence, as well as the quality of technical support, worker training and business planning, that the CLP has only ever had to deal with a handful of failed cooperative enterprises in its entire existence. As Ellerman (1982) concludes, the CLP’s long-term loans and other financial support measures effectively laid the basis for an entire regional economy based on local manufacturing and innovation.

The other less recognized example from Spain is *Cajamar*. Located in Almeria Province in the south of Spain, *Cajamar*, is today the largest cooperative bank in Spain. Its importance is that it served as the core driving force behind a local economic development success story that, very much like in the Basque country, turned a once-dirt poor backwater and Spain’s poorest region into one of Spain’s (and Europe’s) richest and most productive regions. The ‘Almeria Model’ that has been carefully distilled from this experience (Giagnocavo/Fernandez-Revuelta Pérez/Uclés Aguilera. 2012) is based around Cajamar’s self-appointed active role in local economic and community development (felt necessary since most local government capacity was destroyed by the civil war) and, in particular, its patient support for clusters of agro-industrial SMEs serving an increasingly intensive agricultural sector. In addition, as Cajamar’s own capacity developed, it was able to become a constant source of further social innovation, technology acquisition and transfer, and other forms of social and economic development. Giagnocavo, Fernandez-Revuelta Pérez and Uclés Aguilera (2012: 107) conclude their summary of Cajamar’s contribution as one where, ‘a cooperative bank, in concert with the cooperative movement, (.) was able to con-construct an economically stable community through sustainable innovation’.

Alongside cooperative banks formed by civil society are, second, local state-owned and directed financial institutions and development banks. Once again after 1945 in Europe, many countries attempted to reconstruct through a variety of local state-coordinated financial institutions. These were established with the specific intention that they would underpin newly formulated local industrial policies that were being pushed through by newly elected

[14] So successful were the savings banks (and *Landesbanken* – see below) in providing low cost capital to Germany’s SME sector, eventually in conjunction with a public guarantee that was offered to them because they were so well-managed, community-oriented and (so) low risk, that eventually a number of SME business associations in other European countries began to attack the German system as being *too* efficient compared to their own market-driven high-cost private banking sectors, thus unfairly advantaging German SMEs. The European Commission agreed. But rather than promoting a similarly efficient German-style cooperative banking structure elsewhere in the European Union, the neoliberal-oriented European Commission decided it had better dismantle the German system instead. In 2001, the German government finally gave in to the European Commission’s pressure and agreed to phase out the former public guarantees for local savings banks by the year 2005 (Bülbül/Schmidt/Schüwer 2013).

local and regional governments. In post-war West Germany, this meant the *Landesbanken*, or regional banks, which were jointly owned by the savings banks (*sparkasse*) and served as their central clearing institution, and the respective regional governments (*Lander*). They were particularly important after World War Two in providing low cost funds to help the *Mittelstand* (medium sized enterprises) get back on their feet, and also larger enterprises based in their territorial jurisdiction. In Northern Italy, this meant the state-owned but locally operated Special Credit Institutes (SCIs) that, as Weiss (1988) carefully documents, very successfully provided large quantities of affordable financial support (10 year loans at low interest rates) for machinery purchase and workshop modernisation.

Outside of Europe, we find that in post-war Japan, David Friedman (1988) was able to show that the local state was heavily involved in establishing networks of municipal banks and special funds attached to local governments. These local financial institutions were to prove decisive in supporting networks of highly efficient and technologically adept microenterprises and SMEs capable of inclusion in the famously efficient supplier networks built up around Japan's largest industrial companies. And in the USA, the country's most successful regional development bank – the Bank of North Dakota – happens to be a regional state-owned bank. Formed in 1919 to free the local population from the clutches of the big private banks in New York and Chicago that were charging high interest rates on farm loans, the Bank of North Dakota has since then been a major supporter of local businesses and family farms. In addition, it not only prospered without the need for Wall Street-style salaries and bonuses, it survived the global financial crisis without the need for any state bail-out, and it also continued in its role as a major *contributor* (through taxes) into the state's budget.[15]

East Asia's rise to dominance from the 1960s onwards is very much attributable to a range of sophisticated financial intermediation policies, especially involving national and local state development banks (Amsden 2001; Chang 2006). In the immediate post-civil war period, the South Korean state first ensured that long-standing farmer-owned credit cooperatives were thoroughly 'de-landlordised', before establishing numerous inter-linked local state funding bodies and bank-type institutions capable of funding the investment needs of the rural agricultural sector. Food self-sufficiency was reached quite quickly. Meanwhile, eight government funds and a credit guarantee scheme, among other financial interventions, combined to establish a very effective industrial SME development trend in the country (Leipziger/Petri 1993), one that turned out to be especially decisive in building quality subcontracting capacity that could serve the large family-owned enterprises (*chaebols*). Elsewhere in Taiwan, Thailand, Malaysia and Indonesia, similar local branches of state-owned development banks worked with local governments to successfully facilitate rural industrialisation and also, later on, industrial SME development through manufacturing-led technology-based SMEs (Wade 1990; Lall 1996; Meyanathan 1994; Hutchinson 2013).

China learned much from these successful Asian examples. It is not so well-known that China's initial growth impetus came in the 1980s not from FDI, as is often commonly assumed, but from rafts of local government-owned and industry-based Township and Village Enterprises (TVEs). Generously endowed with the latest foreign production technologies, with easy access to the *entrepôt* port of Hong Kong, yet all the while subject to hard budget constraints, the TVEs began to proliferate very rapidly right from the start. By the mid-1990s there were nearly 7.6 million industrial TVEs operating right across China (O'Connor 1998), which represents probably the most successful experience of 'municipal entrepreneurship' of all time. It is even less well known that the crucial financial backing for the hugely successful TVE sector largely came from rafts of urban and rural credit cooperatives (UCCs and RCCs). These were set up and largely majority controlled by local

[15] See 'How the Nation's Only State-Owned Bank Became the Envy of Wall Street', *Mother Jones*, March 27th, 2009. http://www.motherjones.com/mojo/2009/03/how-nation %E2 %80 %99s-only-state-owned-bank-became-envy-wall-street (May 25th, 2014).

governments, but with a broad element of community ownership (Girardin/ Ping 1997). Importantly, the RCCs and UCCs were incorporated into local development plans, and so could receive additional core funding and other forms of support from local government. Local government ownership also gave local savers the confidence necessary to mobilize sufficient local savings (for example, local people knew their savings could not be transferred out of the locality and possibly wasted on supporting heavy 'rustbelt' industries in the north of China).

A little later, Vietnam closely followed China's model and established a similar set of very sophisticated local financial institutions under local government control and oversight. This local institutional mix proved capable of successfully developing the rural agriculture base, before it then turned to very successfully supporting a rural industrialisation and industrial SME development trajectory (Bateman 2010a: 191-198).

In Latin America from the 1950s onwards, and in spite of some obvious limitations, state bureaucracies nevertheless proved vital in providing financial support to numerous industries and smaller suppliers through its Import Substitution Industrialisation (ISI) policies (Amsden 2004). Brazil's state development bank, BNEDES, has almost uniquely provided the driving force behind that country's recent economic miracle. It did this by judiciously supporting key large enterprises (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.

The third constituent part of a 'developmental' local financial system is the private banking sector, but a 'locally embedded' one rather than the free-wheeling type of private bank of textbook and, later, Wall Street fame. Such 'embedded' banks are often family owned, and they willingly operate within a tissue of dense regulations, have long-standing trust-based connections with local businesses and other institutions (Chamber of Commerce, Entrepreneurs Associations, trade unions, etc), and respect traditional societal/community obligations. Unlike the majority of profit-maximising private banks, therefore, the 'embedded' banks we are talking about here provided an important impetus and incentive structure to efficiently support effective local economic development, and for reasons other than pure profit-maximisation. Once again in northern Italy, smaller private banks operating in communities to which they felt an obligation, were inevitably much more willing to support the reconstruction of the local industrial and agricultural sectors, offering low cost loans, grace periods and other benefits to ensure that projects supported had the best chance of success. This very positive process of embedded local obligation and horizontal mutual support structures has been summarized by Becattini (1990) as the 'theory of the local bank'. It was an insight that proved useful in helping to explain why the local financial system in northern Italy was such a positive factor in local economic development compared to its counterpart in southern Italy, where the local financial system was embedded within vertical private patronage (and often criminal) networks which engendered very little trust, reciprocity and mutual support structures (on this, see also Putnam 1993).

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

4. The first post-apartheid government in South Africa opts for 'anti-developmental' microcredit

Before 1996, the African National Congress (ANC) spent many years propounding a state-coordinated economic model with significant elements of financial planning for enterprise development. For example, under the rubric of 'socialism from below' (Satgar 2014), important aspects of the 'developmental' local financial system just noted, such as support for regional/local state banks and mutual banks/financial cooperatives, were included in the ANC's famous Freedom Charter published in 1955. Some aspects of this approach were gleaned from the quasi-developmental state that was constructed in pre-war South Africa in order to more firmly embed white rule (Freund 2013). However, the first incoming ANC government was persuaded to drop virtually all aspects of this alternative economic policy platform, and instead sign up to mainstream World Bank-IMF neoliberal ideas concerning the central imperative of constructing purely private market-driven financial intermediation processes and institutions (Bond 2004). The redesign of the financial system in post-apartheid South Africa, including the *local* financial system, was thus very much undertaken in line with key neoliberal imperatives (McDonald/Smith 2004).

By far the most far-reaching local financial sector development in post-apartheid South Africa was the rapid growth in the supply of microcredit. Even though the African continent has a long history of community-based self-sustainable finance (Shipton 2010), the commercial microcredit model was seen as a radically better way of doing things according the logic of the market and private entrepreneurship. In the run up to the end of apartheid, a number of international development community funded microcredit programs were established in South Africa, notably the Small Enterprise Foundation (SEF) established in 1991. The first ANC government was then given strong encouragement to support microcredit programs. Local and international commercial banks also began to provide microcredit directly via their branch networks, and also via wholesale funding to the main MCIs for on-lending to the poor. The supply of microcredit thus began to rise very fast.

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

Recognizing that it had better do something to seriously improve and regulate the microcredit sector before it entirely exploded, in 2007 the South African government passed the National Credit Act (NCA). A National Credit Register (NCR) was also set up. Both acts brought a little more transparency, discipline, accountability and fairness into what was an increasingly usurious and out-of-control microcredit market. Nonetheless, any gains from the NCA were short-lived. In fact, some even *more* exploitative MCIs began to enter the local market, perfectly symbolised by Capitec (see below). These new participants saw a major profit-making opportunity in the form of unsecured microcredit, which by the end of the 2000s they were supplying in massive volumes. A major new cycle of expansion in the microcredit market in South Africa thus began. And, once again, this latest expansion was hailed as the solution to South Africa's problems. This time, though, the argument was couched not in terms of the now somewhat out-moded and, as we have seen, wholly inaccurate notion of 'promoting poverty reduction and development'. Instead, microcredit was increasingly justified in terms of it being able to resolve what was described, though with very little truth to it,[16] as the new and even more pressing problem facing poor communities around the world today – 'financial inclusion'.[17]

By 2010, however, thanks to this latest dramatic growth spurt, South Africa's microcredit sector and the majority of its poor clients and their families were plunged into a new, and very much deeper, crisis. Nearly half of the 19 million credit active consumers in South Africa were described in 2012 as having 'impaired' credit records (meaning they are three or more months in arrears), while a further 15 % were described as 'debt-stressed' (meaning they are one or two months in arrears). This translated into more than 11 million (more than 60 %) of all credit active consumers in South Africa being defined as over-indebted.[18] South African household debt now amounts to around 75 % of disposable income.[19] How did it come to this? The answer was effectively provided in late 2013 when a large investor in the microfinance sector ended its support for highly profitable microcredit investments in South Africa. The core of the problem in South Africa, as the manager of the aforementioned fund candidly conceded, was that,[20]

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

Bombarded with microcredit in such a way that they simply cannot repay even a fraction of what they owe, with some estimates that up to 40 % of the South African workforce's income is spent on repaying debt,[21] South Africa's poor are today caught in a microdebt-trap of quite unimaginable proportions.

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16 See Milford Bateman, 'Let's not kid ourselves that financial inclusion will help the poor', *The Guardian*, May 8th, 2012. http://www.theguardian.com/global-development/poverty-matters/2012/may/08/financial-inclusion-poor-microfinance (May 25th, 2014).

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

18 See Mandy de Waal, 'Debt traps, the silent killers of the SA's vulnerable', *Daily Maverick,* 7th August, 2012. (May 25th, 2014).

19 See 'Drowning in debt', *Fin24*, 23rd March, 2012. http://www.fin24.com/Money/Drowing-in-debt-20120323 (May25th, 2014).

20 See 'New blow for micro-lenders', BD Live, October 6th, 2013. http://www.bdlive.co.za/business/financial/2013/10/06/new-blow-for-microlenders (May 25th, 2014).

21 See 'Garnishees 'exploit all South Africans' - Webber Wentzel'. MoneyWeb, 15th August, 2013. http://www.moneyweb.co.za/moneyweb-financial/garnishees-exploit-all-south-africans--webber-went (May 25th 2014).

5. The microcredit model proves to be an 'anti-developmental' intervention of historic proportions

The disastrous situation in post-apartheid South Africa has emerged because of at least four key generic problem areas (see also Bateman 2012a).

First, while the microcredit model exists on paper to support income-generating activities, in South African practice it has emerged since 1994 as very much more about supporting simple consumption spending needs. A large number of MCIs emerged that could deal with the obvious risks of consumption lending activity and make considerable sums of money. This new raft of institutions was made up, first of all, by many long-established private commercial banks 'downscaling' into microcredit. In addition, James (2012) found that there was a surprisingly large number of white government officials who had been eased out of their positions after apartheid ended in 1994 and who then began setting up as micro-lenders. The initial client group for these institutions was mainly composed of the upwardly mobile, ambitious and already employed black middle classes. But after 2007, and after the passing of the National Credit Act, the client group changed to include those in the much poorer black communities already in a degree of debt and struggling to cope with grinding poverty. Nonetheless, thanks to such techniques as obtaining a garnishee order on a client's salary, and thanks to high real interest rates (which some MCIs and microcredit advocates go to great lengths to hide[22]), it still proved possible to generate substantial returns from such a client base. Such was the attraction of consumption loans that by 2012 as little as 6 % of the total volume of microcredit advanced in that year was actually used for business purposes.[23] As the current Minister of Trade and Industry, Rob Davies, very accurately summed up the problem,[24]

> *"The (South African) economy is characterised by extensive financialisation, but only a small percentage of investment is channelled towards the productive sectors." (my italics).*

Several major problems were created here. First, the profit-driven move into consumption lending directly created the massive over-indebtedness problem currently washing across all of South Africa's poor rural communities and townships. There can be no doubt whatsoever that canny and uncaring MCIs have managed to seduce South Africa's black population into taking out way too much credit (Bond 2013). Second, we also know that increased consumption spending is always undertaken at the expense of investment. Consumption spending is therefore generally detrimental to growth and development, as we find in Latin America (Ffrench-Davis/Griffith-Jones 1995), and almost everywhere else in practice (Beck et al. 2012). Thus, with a very large part of South Africa's scarce financial resources being recycled back into unproductive consumption spending, this trend since the end of apartheid has inevitably starved many investment projects of funds (the opportunity cost). The increasing systemic emphasis in South Africa on lending to support consumption spending, therefore, has played a negative role in terms of investment projects foregone.

Interestingly, because it enables us to begin to better understand the motives at work here, we can analyse how the microcredit movement in South Africa has responded to the catastrophic impact of over-lending for consumption spending. Rather than rethinking the microcredit model, or agreeing to its phasing out and replacement by more 'developmental'

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22 For example, the Founder and Managing Director of SEF, John de Wit, led a boycott of the reputable *Microfinance Transparency* organisation (co-founded by Muhammad Yunus), when it came to South Africa to assess the real interest rates being charged by the country's microcredit industry. The fear was that if the public and the South African government became aware of the high level of interest rates actually being charged to South Africa's poor, there might be an even bigger backlash against the sector than that already underway – see Bateman 2012a: footnote 26.

23 See 'South Africa: Microfinance and Poverty Alleviation In South Africa'. *Mondaq*, 11th November 2013. http://www.mondaq.com/x/274240/Microfinance+And+Poverty+Alleviation+In+South+Africa (May 25th, 2014.

24 Speaking Notes of The Minister of Trade and Industry, Dr Rob Davies at the Launch of the Industrial Policy Action Plan (IPAP) 2013/14-15/16 held at IDC Sandton on 4 April 2013.

financial institutions, *the leading MCIs and microcredit advocates have instead taken to retrospectively claiming that such consumer microloans are not true microcredit after all*. For example, founder of the Small Enterprise Foundation (SEF), John de Wit, responds to the claim that those South African MCIs mainly providing consumer loans and making significant profits, such as Capitec, are actually not MCIs at all, but nothing more than exploitative 'payday lenders' (Bateman 2012a). Others working in the microfinance sector go even further, claiming that consumer lending is *by definition* not microcredit.[25]

None of these claims stand up to any sort of scrutiny, however. The best illustration of why this is so is provided when looking at the key MCI example often quoted as the best example of an MCI masquerading as a payday lender – Capitec. For at least two reasons, Capitec simply cannot be redefined as something other than an MCI. First, Capitec provides microloans on terms and conditions not unlike – in many cases much *better* (starting at around 31 % interest rates, for example) – than the majority of MCIs across Africa, and in South Africa itself.[26] If Capitec is NOT a genuine MCI in terms of its interest rates, then virtually the entire population of MCIs across Africa – and indeed the world – would have to be similarly disqualified as MCIs. Second, key microfinance advocates in South Africa have long treated Capitec as a genuine MCI.[27] This includes Gerhard Coetzee (2003), the long time Head of the Centre for Inclusive Banking in Africa and one of the most authoritative experts on South Africa's microcredit scene (in 2013, Coetzee moved to a senior position at the World Bank's microcredit promotional unit – CGAP – based in Washington DC). In 2003, Coetzee wrote one of the main evaluations of Capitec, a report that pointedly praised it for its contribution to development and financial inclusion in South Africa and never once questioned whether or not it was a genuine MCI. We should note also that the conventional wisdom in the global microfinance industry is that consumption loans are a completely valid, if not very important, aspect of microfinance (Collins et al. 2009).

The second main problem with the microcredit model in South Africa follows on from the awkward fact that the small percentage of the total volume of microcredit that actually *does* go into supporting investment in South Africa, in the form of microcredit to support an income-generating activity, *still has an almost zero short-run impact on employment and poverty*. This is because the income-generating activities that emerged were simply *not* creating large numbers of new jobs and raising the individual incomes of the poor. Why not? Two short term problems are responsible.

First, as elsewhere across Africa (Page/Söderbom 2012), and as is always the case in recession-hit developed countries as well (Storey 1993; Bateman 2012c), typically high microenterprise *entry* rates in South Africa were in practice almost entirely cancelled out by equally high rates of *exit* and *job displacement* (Bateman 2010a: 71; Kerr, Wittenberg/Arrow 2013). The end result has been nothing more than a familiar local 'job churn' (or 'turbulence') effect (see Nightingale/Coad 2014), one that clearly delivers a very much smaller NET sustainable increase in local employment than microcredit supporters contend.

Second, thanks to lots of new informal microenterprise entrants, there has also been a negative impact of microcredit in terms of helping to reduce average financial returns per microenterprise. Increased market competition in South Africa after apartheid fell led to a general softening of the prices of most simple goods and services produced by informal microenterprises. More importantly, there was a reduction in the average turnover per unit as

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25 This, for example, was the view of several of the senior microfinance program officials in SEFA when asked for their response to the enormous over-indebtedness problems caused by consumer loans in South Africa.

26 See ' Capitec's 'ridiculous' interest rates', *Fin24*, July 1st, 2013. http://www.fin24.com/MyFin24/Capitecs-ridiculous-interest-rates-20130701 (May 25th, 2014).

27 See also the comment by Graham Wright, CEO of MicroSave and a leading microfinance advocate in Africa, who argues that Capitec is actually one of the leading MCIs in South Africa – see Milford Bateman. 'Microcredit has been a disaster for the poorest in South Africa', *The Guardian*, 19th November 2013. http://www.theguardian.com/global-development-professionals-network/2013/nov/19/microcredit-south-africa-loans-disaster (May 29th, 2014).

the finite level of demand (at least in the short run) was divided up between a now much larger number of market participants. It is largely as a result of these specific competition and displacement factors that between 1997 and 2003 self-employment incomes in South Africa fell by an astounding 11 % per annum in real terms (Kingdon/Knight 2005).

Even worse, given the already tense inter-ethnic and community relations in South Africa, many researchers report on the fact that social tensions have been greatly exacerbated thanks to the hyper-competition that now prevails in the poorest communities, and which is traceable to the unnecessary stimulus provide by microcredit. Cohen (2012), for example, reported on the anger and resentment caused by larger and larger numbers of 'poverty-push' petty retailers aggressively competing with each other for a stable or, especially after 2008, a declining level of business, with very few of them able to make any real inroads in terms of increasing income or increasing their number of employees. This situation has not been helped by the arrival of an estimated 1.5 to 3.5 million illegal migrants from neighbouring countries, notably Zimbabwe, Malawi and Mozambique. As growing numbers of poor undocumented immigrants attempt to find paid employment in South Africa's informal economy, ethnically motivated business 'turf wars' are one of the inevitable results of the ultra-competitive local environment thereby created.[28] Attempts to organize increasingly downtrodden informal sector workers have been made by the formal trade unions, especially as a defensive reaction to the continued privatisation of public services and related outsourcing to new rafts of much cheaper individual informal contractors. More recently, this has included immigrant workers. But these initiatives face insurmountable obstacles. Above all, there is the fact that the neoliberal-oriented ANC government remains ideologically committed to as flexible a local labour market as possible (Jordhus-Lier 2010). As elsewhere around the world, notably in the USA and UK (Elliot/Atkinson 2008), the specific combination of large numbers of newly arrived immigrants willing to flexibly work for a lower wage than the local population, allied to the suppression of trade unions, is a core aspect of the neoliberal elixir of economic life.

Interestingly, we can trace the 'over-supply/finite demand' problem we encounter here back to Muhammad Yunus (1989: 156) and his famous claim 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',*

Many have since debunked Yunus's core belief in the idea that 'supply creates its own demand' (known as 'Say's Law'). One of these was the late Alice Amsden (2010) who pointed out that operating under just such an erroneous assumption has actually undermined and destroyed almost *all* supply-side anti-poverty programs established over the last thirty or so years (on this, see also Galbraith 2008: 151-163). One might also view the fundamental logical error here as akin to the error made by those who long argued that famines were caused by 'a lack of food' and that 'more food availability' would quickly remedy the problem, when in fact, as Amartya Sen (1981) famously showed, the fundamental problem was actually the limited purchasing power of the poor that prevented them from buying the food that was often quite widely available in a famine region.

In short, entirely predictably, local supply extended thanks to microcredit has NOT created its own local demand in South Africa. Most communities in South Africa today are already pretty much over-supplied with the simple products and services that potential new microcredit-assisted individuals might wish to provide, *and this was probably the case at the time the apartheid system collapsed in the early 1990s*. Under such conditions, microcredit-

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[28] See 'Analysis: The ugly truth behind SA's xenophobic violence'. *The Daily Maverick*, 28th May, 2013. http://www.dailymaverick.co.za/article/2013-05-28-analysis-the-ugly-truth-behind-sas-xenophobic-violence/#.UnAFdyVwa1s (May 25th, 2014).

stimulated new entry has predictably had little impact on the immediate issue of job creation and it has not raised the average incomes of the poor.

Third, the microcredit sector in South Africa has become the country's very own slow-moving Wall Street-style financial disaster with major knock-on solidarity-destroying effects in already alienated communities. Far too many high-profile microcredit supporters and policymakers in South Africa, as very much elsewhere (good examples are Otero/Rhyne 1994; Robinson 2001), bought into the textbook myth of the perfectly functioning free market and all of the unrealistic assumptions that thereafter followed. The central mistaken belief therefore emerged that commercialized MCIs would very dutifully stick to their declared corporate mission statement and *responsibly* lend to the country's poor. Indeed, on the assumption that all MCIs were trying to help the poor, all that was really required, according to the most naïve (for example, Simanowitz 2007), was simply to monitor an MCIs 'social performance' in order to offer friendly advice to them on how to improve matters in future, advice that would be readily taken up and implemented without question. Just possibly more than anywhere else in the world, in South Africa this assumption proved to be quite spectacularly wrong. In fact, as noted above, it is now abundantly clear, and accepted even within the financial sector itself,[29] that the *real* aim of the private banks and MCIs in South Africa today is not so much to help their poor clients, *but to extract as much value from them in the shortest time possible and no matter what the eventual consequences for them* (see section 6 below). By promoting, achieving and, at times, indirectly celebrating, this narrow goal, the microcredit industry in South Africa has greatly contributed to the further corrosion of all remaining forms of inter-class, inter-ethnic and inter-community solidarity, trust, mutual support and reciprocity.

The best illustration of the depth of problem created here is represented, once again, by the aforementioned Capitec Bank. The fast-growing Capitec Bank has been singled out by many analysts as *the* pioneer MCI in South Africa in terms of excessive profiteering and exploitation of the very poorest. Indeed, many now accept that Capitec as nothing less than the country's very own version of Banco Compartamos (see above). Just as in Banco Compartamos, Capitec stands out among other MCIs in South Africa for two developments not quite in keeping with a supposedly pro-poor institution. First, there are the spectacular profits and dividends reaped by shareholders since its establishment in 2001. Second, there are the equally spectacular salary and bonus payments self-awarded to its senior managers, especially to its high-profile white South African CEO, Riaan Stassen, rewards that have turned him into one of South Africa's richest net worth individuals.[30] It is not surprising, therefore, that Capitec has come under much criticism for having exploited South Africa's poor. Moreover, this process actually took place under the noses of a number of senior ANC figures who collectively invested in Capitec.[31] To cap it all, there is a steadily growing fear that the rapid growth business model that actually underpinned Capitec's fabulous financial rewards to date, is now finally coming apart at the seams[32] (though, pointedly, its (in)famous CEO, Riaan Stassen has rather conveniently departed into early retirement[33]).

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29 See 'New blow for micro-lenders', BD Live, October 6th, 2013. http://www.bdlive.co.za/business/financial/2013/10/06/new-blow-for-microlenders (May 25th, 2014).

30 Awarded in 2004 a personal shareholding of 167,645 shares priced then at R7.61 per share (i.e., a total value of around R1.3 million), in mid-2012 Stassen off-loaded a fifth of his shares for nearly R100 million (around $US11.5 million) at a price per share of around R220, with nearly R400 million (around $US46 million) of *Capitec* shares still held by his private investment company. See 'R80m share bonus for Capitec boss', Fin24., May 6th, 2013. http://www.fin24.com/Companies/Financial-Services/R80m-share-bonus-for-Capitec-boss-20130506 (May 25th, 2014).

31 See 'Capitec unaware share sale may have funded the ANC', *Moneyweb*, 28th September, 2012. http://www.moneyweb.co.za/moneyweb-financial/capitec-unaware-share-sale-may-have-funded-the-anc (May 29th, 2014).

32 Notably, one financial analyst has pointed out that since 2013, around the time in fact when CEO Riaan Stassen took early retirement, Capitec has rather worryingly begun to roll its loan book into longer-term loans, a process famously coined by Wall Street as 'extend and pretend'. This has had the effect of postponing when clients formally go into arrears, which maintains saver confidence and 'keeps the show on the road a little longer'. See 'Charlie Graham', 'Capitec's results unpacked: drop the hype, check the numbers – and be afraid', *BizNews.com*, September 26th, 2013.

The fourth, and perhaps most deleterious, problem with microcredit in South Africa relates to its effect on the longer-run chances of achieving a sustainable local economic and social development trajectory. Many analysts initially stated that microcredit was the perfect solution to South Africa's post-apartheid problems because it would gradually build up an enterprise sector, which would in turn promote growth and development. Notably among these optimists was Zambian economist, Dambisa Moyo (2009), who, with quite stunning naivety and on the basis of numerous misunderstandings,[34] announced that microcredit was one of the main solutions to South Africa's poverty, and to the wider issue of under-development and unemployment across the entire African continent. However, Moyo was quite wrong here. It is well established that capital misallocation, which undermines growth and development, involves one or both of two principle problems that Moyo failed to pick up; first, we have static allocative inefficiency when scarce financial resources are wrongly channeled to enterprises that are simply too small, and we have dynamic allocative inefficiency when financial resources are channeled to less productive enterprises rather than more productive ones (Foster/Haltiwanger/Syverson 2008).

In general, we find that formal SMEs are a far more powerful force behind productivity growth and sustainable poverty-reducing development than informal microenterprises and self-employment ventures. If growth and development are desired, therefore, formal SMEs should receive priority in any capital allocation mechanism over informal microenterprises and self-employment ventures. Yet this is precisely NOT what the microcredit industry in South Africa, or anywhere else for that matter, sets out to achieve.

For a very good illustration of the importance of this point let me just turn for a moment to the important case of Latin America (for a fuller discussion of this important example, see Bateman 2013a). In a high-profile publication released by the Inter-American Development Bank (IDB) in 2010, '*The Age of Productivity: Transforming Economies from the Bottom Up*', the IDB points out that for a long time (at least until the late 1990s) the continent was trapped in poverty and under-development. The principle reason for this, according to the IDB, was because the continent's private financial institutions channelled far too much of the available financial resources into low-productivity informal microenterprises and self-employment ventures (the 'wrong' enterprises), and far too little into more productive formal small, medium and large enterprises (the 'right' enterprises). This allocative inefficiency was discussed very graphically, with the IDB pointedly noting that the last twenty years its financial institutions had achieved nothing more than 'the pulverisation of economic activity into millions of tiny enterprises with low productivity' (ibid: 6). Informal microenterprises and self-employment ventures are seen as by far the most inefficient enterprise structures, and their expansion leads to a very negative outcome because 'resources are (then) locked up in very small – often one-person – firms, of very low productivity' (ibid: 69). The IDB also repeatedly denounces the role played by informality, which all too often ends up 'shielding small firms – the vast majority of which are very inefficient – from the competition of better,

http://www.biznews.com/thought-leaders/2013/09/capitecs-results-unpacked-drop-the-hype-check-the-numbers-and-be-afraid/ (May 29th, 2014). The latest news would appear to confirm that things are slipping fast. See Malcolm Rees, 'Capitec bosses ditch R175m in shares as sector cracks', *BDLive*, May 18th, 2014. http://www.bdlive.co.za/businesstimes/2014/05/18/capitec-bosses-ditch-r175m-in-shares-as-sector-cracks (May 29th, 2014).

33 See 'Capitec earnings up as CEO retires', *Fin24*, September 25th, 2013. http://www.fin24.com/Companies/Financial-Services/Capitec-earnings-up-as-CEO-retires-20130925 (May 29th 2014).

34 Apart from misunderstanding the microcredit model and its history, Moyo's (2009: Chapter 9) chapter dedicated to the supposed impact of microcredit contains numerous logical flaws and untenable propositions. Her rendition of the development impetus given by microcredit, for example, starts from an example from her native Zambia, where she invites the reader (page 209) to, "Think of a woman selling tomatoes on a side street. …[T]his group – the real entrepreneurs, *the backbone of Zambia's economic future* – need capital just as much as the mining company" (my italics). However, Moyo is completely unable to specify an actual *mechanism* by which more and more tomato sellers will aggregate into a sustainable growth and development trajectory: it is simply *assumed*. Nor does she refer to the fact that there is simply no economic history to confirm from anywhere that expanding the scope and scale of such simple economic activities might be a suitable foundation for sustainable economic development (see the discussion in Bateman 2010: 96-99; for probably the best short explanation of why Africa will not develop through microcredit, see Chang 2010, 'Thing 15').

more productive business models' (ibid: 67). In a nutshell, the IDB effectively blew out of the water the entire case for intermediating scarce financial resources through the microcredit sector.

But there is even more to worry about. As Vargas (2012) noted in relation to Bolivia (but it's a global problem – Farrell 2004), the expansion of the informal sector, thanks to the inefficient financial intermediation processes the IDB condemns, all too often serves to gravely undermine the sustainable development of the formal SME sector. The enlarged informal sector does this because it can take valuable demand (albeit often just temporarily) *away* from more productive SMEs that would otherwise allow those SMEs to operate at a more efficient scale of operations, deploy the best technology, train their workers, reinvest in new products and processes, and so on. Crucially, the informal sector in Bolivia 'crowds out' the formal SME sector not because it is more competitive than formal sector SMEs in a positive (Schumpeterian 'high-road') sense, but because it is able to undercut the formal SME sector by paying subsistence wages, routinely avoiding any tax responsibilities, demonstrating no concern to invest in safe working conditions, and so on (the 'low road' option).

The financial intermediation problem raised by the IDB in Latin America, as well as the unfair competition dynamic, are certainly not restricted to that continent, but have both befallen many other countries around the world (Bateman 2010a). Notably in Bangladesh, for instance, where a UK government research report (DFID 2008) found that formal SMEs have huge problems accessing financial support, on the one hand, while on the other hand, individuals and informal microenterprises are being aggressively encouraged to take on amounts of microcredit far in excess of what they can reasonably repay. The end result, entirely predictably, is a Bangladesh economy today that is dominated by informal microenterprises operating alongside a formal SME sector that is probably the weakest and most under-invested in South East Asia. We find almost exactly the same 'missing middle' problem today in Cambodia (Bateman 2014: 16-17) and in India (Karnani 2011).

It is therefore of considerable importance to South Africa that its microcredit-dominated local financial system increasingly channels the country's scarce financial resources *towards* the most unproductive informal microenterprise and self-employment ventures, and so *away* from the most productive and sustainable activities pertaining to formal industry-based SMEs. A number of crucial barriers to local growth are erected as a result.

One, first of all, is that the gradual diversion of scarce funds into the informal sector has taken place in South Africa. Against most predictions made as the apartheid economy was consigned to history in 1994, the low paid, insecure, no-growth informal sector expanded to become the core employment opportunity for the poorest black communities (Wills 2009). The most important part of the informal sector in South Africa is in the retail sector, with the informal manufacturing and services sectors quite small in comparison. In practice, this means South Africa's informal sector is mainly simple street trading activities, including so-called 'barrow boys'. In 2007, nearly 500,000 individuals were engaged in such activities (ibid: 48). Today, in the aftermath of the global financial crisis of 2008, the formal sector remains second to the informal sector in terms of jobs growth. As one recent report noted, "Since January 2013, the informal sector has added 73 799 jobs, compared to a total decline of 241 536 permanent and temporary jobs, reflecting the growing importance of the informal sector in the South Africa labour market".[35] And as another report summed up the situation, "The data suggest that South Africa's formal labour market is gradually disintegrating" (Adcorp Employment Index 2011: 2).

Turning to the other side of coin here, we find the programmed withdrawal of financial support for the formal SME sector has seriously undermined its ability to grow and take

[35] See 'Jobs 2013: Informal sector shows SA who's boss', Mail and Guardian, 13th January, 2014. http://mg.co.za/article/2014-01-13-nearly-24-000-new-jobs-reveal-informal-sectors-worth (May 29th, 2014).

advantage of new demand patterns. This under-funding of the SME sector has been allowed to take place, moreover, even though it has been widely recognised in South Africa (and elsewhere) that formal manufacturing-led SMEs are the key to sustainable local job generation (Pollin et al. 2007; Bateman 2010b).[36] Most surveys undertaken in South Africa repeatedly point out the extent to which formal SMEs have very serious difficulty in gaining access to credit on appropriate terms and maturities (Turner et al. 2008: 15), especially if the applicants originate in the black community. Partly because of this credit constraint, there has been very little real growth in the formal SME sector. Moreover, much of the growth that has taken place in the SME sector appears to have been in the services sector, which is widely seen as much less impactful on growth and development compared to industry and manufacturing. It also does not help that much of the supposed growth in SME numbers in services is actually quite artificial and socially damaging, such as when certain activities in large enterprises are outsourced to 'new' SMEs deliberately set up to receive a contract (and able to undertake this contract work very cheaply, among other things by avoiding tax, being non-unionised, employing informal labour, etc). For example, Tregenna (2010: 1452) points out that as much as a fifth of the total growth of private services employment between 2001 and 2007 in South Africa is related to the simple outsourcing of cleaners and security guards.

One particular problem, yet also opportunity, we must consider here, as Philip (2010) reported, is related to the 'deagrarianisation' dynamic that arose in South Africa under late apartheid. Historically, this robbed poor communities of one of the first and most basic foundations for the growth of local micro- and small enterprises operating in the local economy – local food production. With limited local food production, there is little scope for the growth of local processing, packaging, distribution, retailing, and other related and more diversified local small enterprise activities. As has long been recognised, achieving local food self-sufficiency and growing local financial surpluses constitute an important foundation for subsequent local industrial development through the development of important backward and forward linkages (Vorley/Fearne/Ray 2007). However, with little access to good quality land, increasingly small plots of land due to inheritance laws and traditions, land degradation through over-use and little replenishment through organic fertilizer, and crucial supporting infrastructure purposely not made available to them, black rural communities in South Africa largely failed to develop a local food-producing rural economic structure. Thus, one of the principle forms of bottom-up impetus for the sustainable growth of a local micro- and small enterprise population – local food production – was almost completely missing in the black areas of apartheid South Africa.[37] Thanks to the large numbers of local petty traders, food was largely secured instead from *outside* the local community, mainly from productively efficient white-owned farms and agricultural cooperatives that made extensive use of cheap black migrant labour. Among other things, this further exacerbated the structural oppression that was apartheid. Accordingly, for a number of reasons in addition to the job-creating potential, in the post-apartheid era the development of the local food economy would appear to be a major priority for the South African government.

Pointedly, however, two microcredit-related barriers have been important in *preventing* any programmed breaking away from this anti-development local economic/agricultural structure. First, because of its 'too inflexible and too expensive' terms we know that microcredit is unsuitable for agricultural development (Harper 2007: 93). So even as the other post-apartheid structural problems just noted above were gradually being addressed and partially

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[36] For example, the IFC's Enterprise Survey in South Africa (IFC, 2007) found that for formal manufacturing-led businesses 'access to finance' was the third most important business environment constraint, topped only by 'crime, theft and disorder' in first place and 'electricity' in second place.

[37] White farming, on the other hand, flourished under apartheid, thanks to larger land parcels, large volumes of state subsidised credit, quality state provided extension services, comprehensive irrigation schemes, farmer-owned cooperatives taking produce to final markets enjoying price supports, and so on.

resolved, improvements to the local food production system were *still* not possible even with more microcredit. For example, agricultural cooperatives involving only white farmers were a major reason why agriculture under apartheid spectacularly succeeded, but now that it is black farmers that are forming agricultural cooperatives they have pointedly not been allocated anywhere near the high levels of state financial resources, notably subsidised credit, that was earlier committed to the development of white-owned cooperatives. Instead, black farmers and their cooperatives are told to 'get by on their own resources' or 'tap into microcredit', both of which are an obvious recipe for failure (Bateman 2010b). When practise shows time and again that a source of affordable and/or subsidised and long-term capital is needed to establish an efficient agricultural sector in general (Chang 2009), and agricultural cooperatives in particular (Bateman 2007b), the offer of microloans at anything up to 60 % per year interest rates is nothing more than a cruel distraction.

Second, because of the easy availability of microcredit and the low entry barriers pertaining to the trading sector, after apartheid ended very many in the rural community began to establish their own food trading informal microenterprises.[38] However, in the ultra-competitive conditions thereby created, margins were driven down to near zero. Little real accumulation was therefore possible. Accordingly, very few petty traders in South Africa have been able to sustainably grow their operations, or else self-finance a move forward or backward in the supply chain in order to develop more sophisticated and/or more productive activities. And, once again, because of the high costs and strict terms just mentioned, nor is being able to easily access a microcredit going to facilitate this growth/diversification process.

The advent of the microcredit model has thus done nothing to help transform the weak apartheid-era rural agricultural and food production structures into an engine for local growth and development. Key institutions that prefigure local growth all over the world, notably agricultural cooperatives, are simply impossible to establish and build in conditions where microcredit is virtually the only source of capital for the poor. Moreover, by also helping to flood the poorest communities with petty traders, the growing ubiquity of microcredit has effectively *prohibited* the growth of a more sophisticated and growth-producing food-based raft of local enterprises engaged in processing, packaging, distribution, and so on.

The arrival of the microcredit sector in South Africa was initially greeted by celebration in the international donor community and in the South African government too. The experience since the mid-1990s has shown, unfortunately, that the microcredit sector has precipitated a major development setback in the country. The informal sector in South Africa has taken on a major role in South Africa as the default generator of jobs in the poorest communities, generously supported by South Africa's rapidly expanding microcredit sector. However, not only do such informal jobs and informal microenterprises offer often appalling working conditions and financial rewards, they are quite simply NOT building the foundation upon which any sort of growth and development dynamic that might one day radically improve the situation.

Put simply, the microcredit sector has absorbed a substantial volume of South Africa's scarce financial resources that would have been far more productively invested in sustainable businesses, including formal manufacturing-led SMEs. The South Africa government is now waking up to this dilemma and that the expanding microcredit sector is one of the pivotal issues inhibiting sustainable development today. All told, South Africa's MCIs can best be described today as 'cathedrals in the desert' – hugely profitable and prestigious institutions standing tall in the financial community, but increasingly surrounded by a vast desert of poverty that they have themselves very much helped to create.

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

6. The most vulnerable in South Africa's mining regions targeted with microcredit

As if the negative impacts arising from South Africa's exposure to the microcredit model were not bad enough already, in 2012 an even more damaging development came to light (Bateman 2012a; Bond 2014: 215-220). It emerged that South Africa's MCIs were maximizing profits by deliberately targeting some of the most vulnerable and exploited individuals imaginable; migrant workers employed in the crucial mining sector in South Africa. Long one of the most profitable business sectors in the world, it is an uncomfortable fact for many in South Africa that, at the same time, for the employees mining is one of the most under-paid, exploitative, physically demanding and dangerous occupations anywhere in the world.

The city of Rustenburg is the focal point for much of South Africa's hugely important mining industry. The multinational corporations that own the mines around Rustenburg generate huge profits from the mining of gold, platinum and other rare minerals. However, the individual miners, as well the local community of Rustenburg, do not benefit very much from the extraction of such resource wealth. Rustenburg is part of the Bojanala District Municipality, which has an unemployment rate of around 40 %, yet the bulk of the miners are actually migrant labourers brought in from the rural areas outside of Rustenburg by labour brokers hired by the mine-owners. The reason for this preference is easily apparent: migrant labourers coming from these very poor areas are even cheaper and more tolerant of abuse and poor working conditions than mineworkers that might be recruited locally. But away from home and their families, with a generally low disposable income thanks to the necessity to support two households (the family household in the rural areas and their lodgings at the mine), working under very harsh and dangerous conditions, and also all too often financially illiterate, many of the migrant mine-workers are especially vulnerable. As such they have sometimes been described in the financial community, rather unfortunately in the light of recent events (see below), as 'perfect targets'.[39]

It was the presence of so many 'perfect target' clients in Rustenburg that drew formal financial institutions to this city like bees to honey. In the city of Rustenburg alone, in addition to numerous payday lenders and traditional loan sharks (*mashonisas*), a total of 81 formal MCI branches operate to provide financial services to a population of around 250,000 people. Among this number we find ABIL, Capitec, the big four South African banks, Blue Financial Services, Bayport, Real People, Finbond and Old Mutual. These are all reputable financial institutions, we need to emphasise, with almost all of them registered on the Johannesburg stock exchange. As of early 2012, the MCI with the largest presence in Rustenberg is ABIL with 19 outlets in the town, followed by JD Group with 16, Capitec with 10, Nedbank with 9, StanBank with 7, and ABSA with 5 outlets (Citi Research 2012). If we take the population of Rustenburg as 250,000, we find that we have one formal microcredit provider operating in Rustenburg for every 3,000 individuals. This is a simply staggering number of formal microcredit outlets in such a small area, way beyond even the most liberal interpretation of the supposed need to support local micro-entrepreneurs and achieve 'financial inclusion'.[40]

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[39] Confidential email commentary on the situation from a senior financial analyst employed at one of the largest commercial banks in South Africa, following a lecture by the author on the theme of 'Why doesn't microfinance work?' at Witwatersrand University, Johannesburg, on September 19th, 2012.

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

Moreover, a good number of these MCI outlets are deliberately based on the mining premises in Marikana. Importantly, Marikana is the location where on August 16th, 2012, a massacre of 34 mineworkers was carried out by police brought into the Lonmin Corporation's Marikana platinum facility to break a strike. This incident represents the worst violence in post-apartheid South Africa to date and, crucially, it took place against a background of massive indebtedness among the Marikana mineworkers. In fact, as very many media reports made perfectly clear, it was precisely the massive level of over-indebtedness of the Marikana miners that helped precipitate the confrontation that led to so many deaths.[41] The problems included the fact that a good proportion of the mineworkers were illiterate, and certainly most were *financially* illiterate. Even though the salaries for rock-drillers (the most dangerous occupation in the mine) were above local levels for many other occupations in Rustenburg, this turned out to be scant compensation for the horrendous working conditions, the job insecurity, the alienation from family and the sheer scale of the inequality involved in the mining sector in general.

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

It is surely not surprising to find that some analysts (Bateman 2012a; Bond 2013) have argued that the carefully programmed over-indebtedness of so many mine-workers in Rustenburg played an important role in helping generate the appalling conditions that gave rise to the Marikana Massacre. When stratospherically high levels of over-indebtedness among vulnerable and physically stressed individuals are overlaid upon other pressing economic and social problems, why would we be surprised to find that the resulting pressure can only be contained for so long?

7. Concluding remarks

This article has argued that microcredit has played a calamitous role in the hoped-for local economic and social development progress of post-apartheid South Africa. In particular, since the end of apartheid, South Africa's scarce financial resources have been increasingly intermediated into consumption spending and, where 'invested' at all, into no-growth ultra-low productivity informal microenterprises and self-employment ventures. As in many other countries with a similar financial intermediation structure, the end result has been the deindustrialisation, informalisation, disconnection and primitivisation of the average local community, and so a poverty trap has effectively been created thanks to microcredit. In addition, the inequality, aggressive competition, and unfairness underpinned by the microcredit model have helped to undermine and destroy important solidarity bonds both

[41] See Rebecca Davis, 'Marikana: The debt-hole that fuelled the fire', *Daily Maverick,* 12th October, 2012. http://www.dailymaverick.co.za/article/2012-10-12-marikana-the-debt-hole-that-fuelled-the-fire/#.U6rAYo3wC70 (May 25th, 2014).

within and across South Africa's local communities. This does not bode at all well, of course, for a country desperately attempting to cast off its vicious apartheid legacy and to move into a new era of social justice and inter-racial accommodation. In the final analysis, microcredit can best be described as South Africa's very own sub-prime-style disaster. Very much like the original US version (Dymski 2009), expansion of the microcredit sector has spectacularly benefitted a tiny elite working within and around it, whilst simultaneously destroying many of the most important pillars of the South African economy and society.

Thanks not least to the Great Recession, the long-predicted inevitable outcome of all free market/neoliberal experiments (Polanyi 1944; Minsky 1986), but also thanks to the mistake of using core neoliberal principles as the foundation of international development policies (Stiglitz 2002; Chang/Grabel 2004), we are now unsteadily entering into what has been described as 'the post-neoliberal world'. A sensible, not to say *urgent*, move for South Africa, and for the international development community and Africa as a whole, would be to begin to sensibly reassess the impact of by far the most important manifestation of *local* neoliberalism – the 'anti-developmental' microcredit model. Analysis of what constitutes a 'developmental' local financial structure, as briefly presented in section 2 by way of contrast to the microcredit model, shows where South African policymakers and the international development community now need to be thinking today in terms of constructing an effective post-neoliberal local financial system.

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