

Credit Where Credit is Due:
Assessing the Embedded Ethics of Microfinance

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12 December 2008: DRAFT
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In our rapidly globalizing world, the device of microfinance seems to hold promise as one of the great levelers. The field has developed spectacularly over the last three decades, beginning as a small community lending operation in Bangladesh and spreading as an antidote to the impoverished commercial disenfranchisement of over one hundred million of the world's least well-capitalized people. Proponents of the strategy have worked tirelessly to promote the goals of the movement: the distribution of small "micro" loans to poor borrowers spread across countless remote villages in under and undeveloped corners of the world. Myriad articles have been written bewailing the growing gap of poverty between the wealthy and the poor, many of which identify the concentration of productive capital resources among the world's well-off as a key impediment to securing a stable future for the world's weakest. Against the backdrop of our relentlessly credit-driven world, it is tempting to promote access to capital as a critical human right in the twenty first century. Although I have growing reservations about this intense reliance on debt as the primary and critical tool to address the world's inequality of income and opportunity, pragmatism demands that we concede this point for the moment in order to evaluate the ethical implications of the system of microfinance.

As the microfinance industry has grown from its infancy as primarily a philanthropically funded endeavor into a full-fledged segment of the financial markets with the capacity to attract private investors through complex securitizations, it becomes critical to align the priorities of justice with the demands that are made upon microfinance, in order that this new capital will be put to work in a way that achieves the overall goals of the assisting the poor. The focus, then, of this inquiry is to analyze the ethical implications of some of the more subtle methods by which microfinance is delivered to the people of the developing world, to understand whether these methods of delivery cohere with the apparent goals of the microfinance movement and its commercial and non-commercial practitioners, and to assess certain devices through which, were they to be adopted, we might improve the moral posture of the system. The especial relevance of these discussions relies in part on the presupposition that the aims of those who support micro-finance extend beyond a merely lucrative focus, embracing as a parallel goal the improvement of the lives of those people in the developing world who are as hungry for food as they are for capital.

There are two broad types of evaluations that we might undertake to analyze the efficacy of microfinance in the pursuit of its ambitious goals. On the one hand, empirical studies may be conducted to determine the impact of microfinance on the lives of borrowers. The statistics that are generated thereby can be sorted further into two distinct perspectives: measurements detailing the growth and development of the microfinance programs themselves, or measurements seeking to measure the impact of the program on the lives and the life-chances of their borrowers. In the case of the former, studies have reviewed metrics such as the number of borrowers, the overall amount of capital disbursed, the geographic dispersion of funds, the nature and diversity of business purposes undertaken with the capital, the rates of repayment, ROI for the lenders, and any other number of additional measurements. For the latter exercise, where the aim is to measure the borrower-level value of the programs, researchers study the *impact* of this provision of credit on people's lives. Has their standard of living increased? Has the disposable income of the household increased? Do they have better access to healthcare, to proper nutrition, to suitable housing (all corollary goals of the access to capital)? Have the

overall economies of the villages increased, of the regions where this type of capital is available? What has been the multiplicative value of the money supply in these countries?

In general, scholars lament the limited extent to which these empirical questions have been studied in any degree of precision. Of those studies that have been conducted, the samples analyzed are geographic or program specific, focusing on the impacts of microfinance on one or two communities or regions. Hard data such as income level, net assets, or consumption levels for these poor, rural borrowers are challenging to collect. Evidence is either aggregated into broad measures that extol the overall provision of capital (effectively taking as a given the benefits of the microfinance loans) or else are organized in anecdotal format only, largely insufficient in scope to provide any dispositive resolutions to the aforementioned questions. Yet the world's opinion of microfinance and its benefits has not awaited the verdict of serious inquiry; the overwhelming public sentiment is favorably disposed toward microfinance as a device to provide opportunity to poor and developing people across the globe. Microfinance is poised to grow in magnitude and scope. For this reason – since the cart is way ahead of the horse, so to speak – it is incumbent upon us to assess the information that we now have and to consider its implications, in an effort to ameliorate whatever latent ethical shortcomings may compromise the system's ability to interact on a just basis with the affected populations in rural geographies around the world.

First, I situate this inquiry within the landscape of contemporary academic research regarding microfinance. Special emphasis is placed on summarizing the conclusions of certain non-statistical ethnographies observing the impact of microfinance on the lives of local borrowers, for it is principally through these observations that we can best understand the moral dimensions in which microfinance operates. Having laid this foundation, I then apply an initial set of normative ground-rules to address certain of the ethical implications drawn from the extant ethnographic and empirical research, and conclude with a proposal for directions for future research.

By in large, scholarly work on microfinance operates along the same lines as the journalistic assessments of the impact of the programs. It is an easy story to tell, the manner in which credit is operationalized as a basic human right and an antidote to the clutching poverty that grips so many. Indeed, most commentators have rather uncritically concluded that the provision of credit to rural villagers is not burdened by any special ethical issues, and have implicitly accepted any one of a number of popular storylines as a consequentialist justification for their support and hortatory pronouncements of further growth (Pineda and Walusis n.d.): empowerment of women, anecdotal stories about businesses started by the rural poor, the value of direct interaction between western philanthropies and developing peoples.

One cohort of authors has adopted the role of apologist, led more by initial biases in favor of the institution, in place of arriving at conclusions through inspection and review. These commentators are clearly praiseworthy (even a superficial analysis of their tone and the scope of their investigation reveals a clear preconceived bias): they are in favor of microfinance; they want it to work as a tool to alleviate some of the suffering and enhance the opportunities of the world's poor (Santiso 2005). Their belief set can be seen to include a conviction that access to credit is valuable – some have even enumerated the access as a fundamental human right (Hudon, *Should Access to Credit be a Right?* 2007). Many authors write somewhat unreflectively about the impact of microfinance (Annapurna 2008): they tend to cite statistics such as total

amount of lending deployed through the practice (taking as a given the positive instrumentality of making these loans), the geographic penetration of the programs (taking as a given the portability of this type of assistance across multiple geographies). Only through inference are the goals of poverty eradication achieved, not through direct study of the increase in wealth of individual borrowers by any reasonably robust measure. Indeed, to the extent that statistical measures are used at all, the most prevalent metric appears to be the rate at which the loans are repaid to the lenders, presupposing that through the measurement of recovery rates we obtain some reliable indicator about the impact these loans have had on borrowers.

Other researchers have harnessed their focus on certain shortcomings within the metrics used to evaluate the impact of microfinance. In general, these authors possess a general bias that microfinance programs are ameliorative to the conditions of the poor, although they believe that this claim is difficult to conclusively prove at present, and therefore call for an improvement to the statistics that are employed in measuring the outcomes. They point to such things as the difficulties in generating statistics that reliably capture the effects of these programs on the increase of wealth in the rural borrowing populations (Hulme and Moore n.d.). A variation to this criticism highlights the difficulty of accurately conducting a cost-benefit analysis of microfinance versus other poverty relief programs, due to the challenges of ascertaining the true non-subsidized cost of providing financing (Guérin and Servet 2003). The embedded motif within these critiques is that through enhancements to the measurement techniques, the overall amount of capital available through microfinance will grow, which would be better for the affected communities overall. Some of the measurement-oriented criticisms reserve judgment: one vein of research concludes that no meaningful evidence has been supplied in defense of microfinance (Adams and Raymond 2008), and therefore call for immediate focus on better measurement prior to devoting additional resources to the field. Other authors possess a more subtle approach, declaiming the ability to measure the true impact of microfinance on the lives of the poor because of the failure to measure so-called “social capital,” or other societal devices of value (Vanroose 2007).

Another camp of writers can be seen to assume the positive instrumentality of microfinance, but have certain suggestions about improving the design of microfinance to make the system more profitable, or to make the loans easier to recover. Authors have criticized the device of group-collateralization, for example, as it pertains to microfinance in industrialized economies, where larger loan sizes might prevail (Aghion and Morduch 2000). These authors offer practitioner’s advice: a call to establish regular repayment schedules, the use of refinancing threats, or other sanctions such as exclusion from the village community. Analyses of the ethical dimensions of the system are not apparent in these works.

There is a separate (and much smaller) group of commentators who are exploring a critical analysis of microfinance, attempting to study various aspects of the impact of introducing credit into remote villages around the world. The techniques employed are typically either political theoretic critiques of microfinance, or else ethnographic accounts of the impact of the loans at the household level. In the former category, certain authors have urged for a more exacting analysis of the emergence of microfinance, effectively asserting that the device is an instrument of the capitalist oppressor imposing western conceptions of success and responsibility on primitive villagers around the world. These critiques have typically been rooted in Marxist, communist, or feminist conceptions of economic and communal organizations. One commentator questions the economic value of credit at all, claiming that it fails to increase the

money supply within a Marxist conception of rural economies, citing Soviet agricultural examples. Another commentator lambasts the origins of microfinance as entirely consistent with the dogma of the “developmentalist” framework, effectively forcing into the hands of the poor a tool that “empowers” them to lift themselves out of poverty through some working capital (Brigg 2006). The implication is that if the poor are unable to successfully raise themselves out of poverty through the use of this tool, the responsibility to provide future or further assistance may be rejected due to the poverty now being the poor’s fault. Other authors state that since most microcredit programs are run by men, they reduce women to “welfare objects” (Parmar 2003). Certain authors have made a more nuanced argument: since microfinance may harden and sharpen existing inequalities within rural societies through its reliance on existing social architecture and hierarchies, it may actually serve to reduce the only form of capital that these villagers do presently possess, that is their social capital, as they enter into more and more convoluted relationships with one another, thus further impoverishing the less-advantaged (Rankin 2006).

A less theoretical criticism resides within the handful of ethnographic studies that have sought to understand the influence microfinance has held on household indicators such as net worth, opportunity, and social relations. These studies, typically conducted ‘in the field’ over twelve to twenty-four months, seek to go beyond the unreflective recitation of high repayment rates as a reliable guide to the success of microfinance projects, instead looking to more borrower-oriented measures of microfinance’s success in alleviating the struggles of the poor. Researchers live among the borrowers, attempting to understand the purpose for which the loans have been made, observing regular meetings of the borrowing groups, interviewing members of borrower families, and chronicling the nature by which borrowers are able to repay their loans. Results from these studies are varied and often chilling. A litany of claims has been offered by researchers entailing criticism that asserts, *inter alia*, that borrowers lack an understanding of the terms under which they are borrowing the money, that interest rates (after fees and other charges) are as much as 60% to 120% per annum, and that loans are regularly advanced for consumption purposes rather than capital uses. Others contend that the very systems that microfinance institutions have erected to ensure prompt repayment of their clients indebtedness sometimes evoke negative consequences: the group collateralization of loans has placed women in distinctly adversarial positions, impelling the stronger borrowers to coerce weaker women into repaying their small loans in order to keep the credit flowing for the group. Perhaps not unsurprisingly, reports emerge of female borrowers resorting to extreme measures to repay delinquent obligations. If defaulting borrowers persist in their inability to repay through their own efforts, the other members of the loan circle become a sort of self-appointed collection agency, employing sometimes violent techniques in their efforts to recover on loans. These diverse and humiliating tactics, which will be reviewed in greater detail herein, seem inconsistent with both the supposed aim of microfinance as an agent of poverty-alleviation as well as even impoverished explanations of the demands of justice. A variant of the criticism of group collateralization posits that in certain microfinance systems in which groups borrow collectively to pursue a collective enterprise, the device of the group loan ossifies existing unfair social hierarchies, leading the most powerful members of the group to corruption and self-enrichment, forcing the other members into servile labor roles in exchange for meager wages and the avoidance of socially humiliating sanctions (Wright 2006).

Other evidence obtained in the field has prompted additional (and perhaps counter-intuitive) veins of criticism: that microfinance has inadvertently oiled the gears of the machine it was

designed to replace, with borrowers seeking out established and expensive money-lenders to meet their more regular (but lower cost) interest payments on their microfinance loans, effectively rolling over the obligation of indebtedness to a seemingly less-friendly creditor. Others point to a different manner in which microfinance has interacted with the established rural lending community suggesting that microfinance loans are being regularly funneled into the money-lending system, borrowed from microfinance institutions only to be re-loaned to money lenders as a form of wholesale capital. One of the more astonishing claims details a particular woman who used the lack of loan-level restrictions to her “advantage,” herself becoming a rural money-lender, having obtained money through numerous straw borrowers and from multiple microfinance institutions, here serving in the role of a sort of rural correspondent bank.

These ethnographic criticisms, if taken at face value, describe a series of ethical concerns relevant to problems of exploitation, coercion, and unfair bargaining tactics. As riveting as they are, they join the ranks of existing studies as either descriptive or instrumental, wanting for emphasis in any normative respect. Departing from here, we will walk through a more careful and detailed analysis of some of the claims of the ethnographic studies in an effort to uncover the basis upon which we may conclude the key ethical ideas, as preparation for the normative platform that is subsequently advanced.

Within the ethnographies, efforts are made to be comprehensive, employing such techniques as multiple interviews of the same borrower family at different phases of borrowing (pre-loan, funding, initial deployment of capital, debt service, and amortization), attendance as an observer at loan circle meetings over the course of the survey period, and documentation of the types of interaction between different members of the loan group and how they vary over time. There are obvious criticisms that could be advanced against the validity of these ethnographic techniques. They are plainly unscientific in any statistical sense of the term. There are insufficient data points, there are clear issues of bias that might lead to skewing, there are measurement and data collection issues here as well. Other concerns are the limitations inherent in the geography of the study area – microfinance has been reported to operate through over 3000 microfinance institutions in scores of locales and dozens of countries. It would be inappropriate to regard a specific criticism of a particular program as a broad indictment of an entire industry, in the absence of more comprehensive evidence.

Yet, whether or not the observations of these ethnographies may be seen to be exhaustive, for whatever they may want in breadth or scope they possess in depth and the richness of detail. Moreover, the similarity of certain of the concerns within the ethnographic canon is striking enough to suggest at least the faint outlines of an emerging pattern, thereby commanding our attention and demanding our review in an effort to enhance the success of these programs straightaway. And again, since our main concern herein is ethics rather than effect, it is not inconsistent to query what the impact of these programs may be on each of the borrowers, rather than the aggregate of the borrowers, in an effort to afford equal moral value to the lives of those who are party to these systems.

Having offered this by way of background remarks on the basis of the ethnographic research, I now turn to specific observations made by the various authors. My research has included evidence from broad geographies (Africa, South Asia, and Central and South America). Additionally, although most authors arrive at critical conclusions, at least some of the

ethnographers report a brighter and more positive version of microfinance (see Bebbington & Gomez, 2006). Efforts will be made to understand how these systems differ from those in others across locales.

A leitmotif within the ethnographic criticism of microfinance questions the technique of group collateralization. Traditionally advanced as one of the fundamental bases of the value of microfinance, apologists and practitioners suggest that in the absence of actual hard collateral against which they are able to secure their loans, the method of group collateralization is the principal vehicle upon which lenders rely to ensure timely repayment of the loans that they advance. Perhaps not surprisingly, it is also identified as a fundamental stress point by the ethnographic critics in their study of the impact of micro-finance. The principal ethnographic contention is that this type of joint liability operates in a way that doesn't so much tie the borrowers together in a positive self-help format as it places borrowers in multiple types of opposition to one another (Rahman 1999).

Group collateralization typically operates in the following manner: borrowers are divided into a group or "loan center," comprised of five women, each representative of different families. Although each loan is procured to the individual women, they are only able to continue to obtain credit to the extent that all of the participants in the loan center are able to maintain their loans as current. Proponents claim that these types of practices engender a peer-based loan monitoring system, making the borrowers answerable not so much to the financial institution as to one another, promoting a sense of unity in purpose around the village. Ethnographic critics have found otherwise in their research, demonstrating that this practice is effectively an outsourcing of the loan monitoring and collection functions normally reserved by the financial institution, placing unrelated borrowers in rural villages in strange and novel relations to each other.

When a borrower within a loan center is unable to make the current interest payment on their loan to the microfinance institution, the other women in a loan center are cut off from the opportunity to undertake any future indebtedness until the loan center pays off its due interest. The non-defaulting women suddenly become both borrower and repo-man, resorting to techniques to recover the loan that would be judged abhorrent by any reasonable standard of justice. Researchers indicate that defaulting women are subject to enormous pressure within their villages to repay their loans, leading them to attempt to raise money through desperate means or, if unsuccessful, by taking additional loans from village money-lenders at even higher interest rates. If the defaulting party remains unable to pay her loan, she is publicly humiliated by the others in the loan circle: she is forced (among other devices of shame) to display her hair in a ritualistically embarrassing style. Subsequent methods of loan recovery include ripping the golden marital nose-ring from the nasal septum, appropriating cows, trees, or other hard property, and – at last resort – evicting the defaulting borrower from their dwelling, wresting all worldly possessions in an effort to pay back the principal and interest due (Karim, *Demystifying Microcredit: The Grameen Bank, NGOs, and Neoliberalism in Bangladesh* 2008).

At first shocking, these findings are suddenly more understandable when we consider the environment in which these loans are made. Comparatively large amounts of paper currency are introduced into remote villages, unconnected by major roads or other forms of traditional communication to the outside world. Women, unaware of the cultural background institutions present in the developed world around the practice of lending, borrow these monies, and are

told to police one another without any real oversight by the lending institutions. When one of them is unable to pay, the others are cut off from the sources additional liquidity to which they have grown accustomed, thereby taking their grievances to the defaulting party in a manner historically employed to engender certain types of compliant behavior among the subordinate female population of the developing world.

When the astonishingly high recovery rates of microfinance loans are read within this light, the statistics may be seen as less praiseworthy than they are sickening. Has this provision of credit actually brought violence and destruction on unassuming borrowers? Have people wagered their homes and their dignity over a small loan that was supposed to set them on a course to independence? Have these loans further entrenched some of the latent gender inequalities within rural societies rather than served to liberate women? Indeed, these are the common conclusions among certain of the ethnographic critics of microfinance. Perhaps this is not wholly surprising: in the developed world, multiple overlapping background institutions have been elaborated to contextualize the sometimes contentious process of lending: bankruptcy courts and credit scores, requirements with respect to necessary disclosure, and certain legal protections against over-zealous collection practices. In rural communities, where these systems are simply non-existent, well-meaning strategies built on the paradigm of western consumer lending can be seen to run amok, causing a variety of unanticipated and intolerable outcomes.

This is not an indictment of all microfinance systems built on the group collateralization premise. Indeed, certain other research has shown that this type of group collateralization can be effective and can promote a high level of cohesion and growth within a community. In certain cases in Peru and highland Guatemala, for example, group collateralization has been cited as especially worthwhile (Bebbington and Gomez 2006). There are differences in the design of the group collateralization, however, that we might consider in an attempt to explain the differing outcomes. In these cases, borrowers are not placed into small groups where each is individually responsible for their loans in order to keep the balance of credit flowing to the rest of the borrowing group. Rather the entire community is given a sum of capital to lend out amongst themselves, effectively turning the community into a bank. This is preceded by weeks of seminars and education about the appropriate manner in which these institutions should be developed. Sums of money start small and over time, as villagers select together productive uses of capital, the microfinance institutions inject additional liquidity into these systems, enabling villagers to go from strength to strength, rather than the destabilizing format of the small, non-monitored group loans. In this sense, the community *qua* group collateralization model can be seen to more closely resemble the historic rotating savings and credit association (ROSCA) systems than the small group-borrowing model. The resemblance derives particularly from the sense among borrowers that it is the community's capital that is at stake and to be preserved, rather than some outside form of capital that hasn't the same type of emotional value as a local and hard-earned source of liquidity. Still, other studies contend that even group enterprise is insufficient to guarantee the intended results – elsewhere in Peru, ethnographic studies witness powerful women driving the productive function of the group enterprise, hoarding the profits obtained through the wages of working capital and insufficiently compensating the other members of the group (Wright 2006).

Nor is this the only vein of criticism with respect to group collateralization. Other ethnographers have cited a process whereby group-borrowers are unwilling to co-borrow with the most poor members of their community, and only wish to associate with those others in a loan center

whom they might reasonably believe would have the capacity to repay loans (see Selinger, 2008). This is not unsurprising: we all wish to partner with money-good associates. But for a system designed to elevate the poorest among us, we must take pause to think that it may actually further stratify existing circumstances of income distribution, lifting up those who are (relatively) less in need of philanthropic assistance in favor of the neediest and most impoverished rural poor.

Other ethnographic research asserts the following: notwithstanding the claim that loan counseling is provided to every borrower, it is in fact few and far between (Karim 2008). Whatever restrictions are said to be placed on loans for capital uses only, many are used for purely consumptive purposes. This may be seen as either a consequence of a lack of restrictions or monitoring at the program level or, as one study contends, a manifestation of indigenous cultural norms related to the duty of the matriarch to support family needs above other obligations (Milgram 2006). Other feminist theories assert that female borrowers are subservient to demands upon the capital made by male family members (Karim, *Demystifying Microcredit: The Grameen Bank, NGOs, and Neoliberalism in Bangladesh* 2008). This general area of criticism that loans are not often used for income generating activities but instead for consumption or to repay outstanding debts speaks to the question of microfinance as a type of pyramid scheme. One study asserts that over 70% of loans taken in the Wayanad district of India were used to refinance previous obligations (Mathew 2006). Other estimates have placed the proportion used for consumption in excess of 90% (Adams and Raymond 2008).

What has happened here? What seems most-likely to me might proceed along these lines: a well-meaning effort by caring Westerners and large multinational institutions has become a sort of charitable Dr. Frankenstein's monster, with large and powerful forces entering the rural country-sides of hitherto abandoned and burden societies, areas that are not well ordered – and these forces, in the innocuous clothing of Non-Governmental Organizations (“NGOs”), have entered this arena offering radically destitute villagers the opportunity to take out cash-money in the form of a “loan,” which itself embeds a series of cultural norms that they don't fully know or understand. These societies haven't access to all the underlying background institutions upon which borrowers in the developing world rely. To say that these villagers could decline these portions of paper currency in favor of continuing their otherwise extremely impoverished existence is not a reasonable stance to take. Indeed, the very presence of this easy money places the microfinance institutions in a relationship that can be easily transformed from a voluntary philanthropic relationship to a coercive and exploitative relationship, if only through inadvertent design. It can be seen as coercive in that the money cannot really be declined and exploitative in that these projects unite together illiterate and often innumerate villagers into new and unexplored relationships, tapping multiple generations of societal norms that are now being marshaled to operate in a brand new role, some of which are for the exclusive benefit of the microfinance institution rather than the borrowers.

These criticisms emerge from an environment in which the necessary foundations of just background social institutions are insufficiently constructed to protect the citizens as versus the large multinational. An objection may be advanced that the government has abdicated too much of its authority in favor of the NGOs, in the sense that it fails to take steps to establish an appropriate amount of oversight to ensure that the structures which NGOs are devising are broadly consistent with the prevailing norms of the society and with basic demands of justice. Even if only some of these ethnographic claims are true, such that these NGOs themselves are

effectively (if unwittingly) complicit in or responsible for further ensnaring a deeply troubled population into a deeper and deeper cycle of vicious poverty, social stratification, and gender inequality, then clearly we can conclude that the existing norms in these societies are insufficiently developed to permit the introduction of capital in a way that protects against the possible abuses of fraud, unscrupulous dominance of gender roles, social control, and so on.

Perhaps we arrive at an intermediate conclusion: that we should only encourage microcredit in those societies in which there are present the necessary background institutions of lending: a basic protection of property rights, bankruptcy protection measures (or an equivalent default-driven form of relief), adequate methods for monitoring of borrowers, among other necessary devices of credit regulation. But this intermediate conclusion threatens to lead us to the potentially unappealing determination that microfinance is inappropriate for the poorest and least developed countries, until and unless those countries develop the background institutions necessary to effectively protect the interests of the borrowing public. We will later revisit the durability of this intermediate conclusion when we consider certain of the possible variations to lending that might rehabilitate the institution.

In the interests of a full accounting of the ethnographic findings, it is important to describe an additional component of the evidence. A number of ethnographers upon whom I have relied for data related to the actual operation of microfinance loans further extend their arguments to include a critique of the manner in which the NGO has effectively become an ersatz state, dis-intermediating the actual apparatus of the state in the provision of services that were historically under the aegis of state responsibility. Karim, for example, contends that the government of Bangladesh has effectively withdrawn from its responsibilities to shelter, educate, and secure the liberties of its rural population, in favor of discharging that responsibility through the establishment of a broad NGO mandate, led particularly through the provision of credit. Her argument continues that the NGOs have further appropriated the traditional forms of social norms in rural Bangladeshi society to entangle their constituents in a cycle of credit, control, and social dominance. Although different on the margin, the substance of the neoliberal criticism is the same across the other authors.

These observations, to my mind, confirm a larger question. We are left to ask whether the provision of credit *per se* is an adequate first responder to meet the demands of global justice. We are not looking at providing credit through contractual agreement to well-educated borrowers – in fact, as has been shown herein, the tremendous inequality between the sophistication of the lender and the financial (if not formal) illiteracy and innumeracy of the borrower raises questions as to whether this kind of “assistance” actually carries with it the burden of placing people further into debt, whether social or financial in nature. Reflection is due on this larger question of what characteristics make debt ameliorative and which characteristics make debt destructive – across time, place, and culture. Even if we obtained the appropriate controls for microfinance and set the appropriate background systems in place, would that answer these shortcomings to a philosopher’s satisfaction? The answer to this question is beyond the scope of this inquiry – indeed the pace of microfinance’s growth in some ways forces us to put that question on the backburner for now as we deal with the urgent questions of how it impacts the lives of those who presently borrow. There will be time, there will be time for these other days of works and hands.

We may now begin to establish the normative platform through which some of these adverse hazards might be avoided. As an introductory aside, I would like to review some thoughts on the apparently high interest rates that are levied on microfinance borrowers. Throughout history, there has been a sustained and established effort to assess the ethical implications of rates at interest, with scholars variously tracing the inquiry back to Aristotle, or the Council of Nice, or Bentham's *Defence of Usury* and Smith's *Wealth of Nations*. For the purposes of the present project, I think it would be overly fastidious to provide a fresh or full accounting of the various systems used to evaluate the fairness of interest rates charged in different circumstances, for here I am less focused on the specific equity of the terms of the loans than I am interested in assessing the component systems upon which they are constructed. Nevertheless, a few remarks on interest rates may be worthwhile.

Microfinance scholars typically situate their analysis of interest rates in a way that attempts to study whether such rates (reportedly as high as 60% to 120%) are fair relative to the even higher interest charges of moneylenders, or whether they can be seen as fair in some absolute sense. By way of reference, I incorporate the fine survey of work conducted to review the traditional accounts of fair interest rates (Hudon, *Social Justice with Credits to the Poor: a Neo-Contractarian Approach* 2007). After reviewing the inadequacy of the current system of delivery of microfinance in creating a just interest rate environment, Hudon offers a proposal that relies upon Gauthier's contractarian approach of establishing so-called "reserve" prices by both the borrower and lender, but departs from Gauthier's procedure of concessions based on individual actor's utilities. Instead, Hudon proposes the creation of a "prioritarian" procedure, in which a higher emphasis is placed on the impact of a lower interest rate on the lives of the borrowing poor. At first eye-popping, these rates may be seen to be high relative only to specific case of sustained low interest rates charged to quality borrowers in the modern developed world. By way of comparison, interest rate historians have cited that the nominal interest rate for personal moneylenders in classical Athens was approximately 576% per annum on an uncompounded basis, and those of the typical moneylender rates in New York as cited in law court trials of unlicensed loan sharks at 1300% per annum (Homer and Sylla 2005). Other examples litter the history of interest rates at levels very substantially above the outwardly shocking 120% per annum rates reported to be charged by rural moneylenders in microfinance zones. However, it may not be necessary to advance a claim about the fairness of interest rate levels or bargaining procedures in microfinance in order to obtain a just demand to lower prevailing rates charged to loan recipients.

Here, neither the absolute nor the relative level of the nominal rate itself is the instant target: instead, we need only consider the source of the funding of these microfinance institutions – these being for the most part philanthropic or otherwise socially motivated investors – and ask whether the manner in which the explicit intentions of these investors to provide reasonably priced capital to the developing world has been undermined by the greed of those who would seek to intermediate the loans and provide liquidity to the ultimate borrowers at effectively unreasonably *margins* (in contrast to a criticism of the rate itself). It appears to me that this moral abrogation – that monies are being effectively appropriated and used inconsistently with the expectations of both the donors (the true sources of liquidity) and the borrowers – can richly habilitate a criticism of the high interest rates that prevail in today's systems of microfinance. (Were it not the case that microfinance obtained its capital through these philanthropic sources and instead were forced to approach either the wholesale or correspondent capital markets,

then it would be necessary to place a much greater emphasis on analyzing the underlying ethical claims related to interest rate pricing mechanisms).

Departing from price-driven criticisms of interest rates, the ethnographic evidence presented here compels us to ask: to what extent is the current provision of microfinance consistent with our notions of justice? At the center of the evaluation reside these fundamental questions: have basic requirements of co-authorship been met between borrowers and lenders, or has this system instead been imposed onto borrowers? If the latter, to what extent has a mode of coercion operated as a primary device in the initial issuance of the debt? Has the system, widely heralded as a liberating force, devolved into a sort of exploitative force in the lives of these borrowers?

On the question of co-authorship and coercion, the self-evident inequality that governs the relationship between borrowers and lenders leads us to conclude that certain demanding duties attach to funding participants in this marketplace. Although it is possible that a villager could refuse a \$150 loan from an international financial organization, the actual ability to do so is beyond any reasonable conception of rational choice. Why would a poor illiterate and innumerate villager in a remote rural corner of the world turn down a fistful of cash money from an outsider hell bent on offering some enlightened improvement to the established routine? Yet, within the context of the easily foreseen acceptance of the loan, we can't forget that the language and symbolism that underlies the transaction is not interpretable to the would-be borrower. The village culture may not have historically comprised lending as a normal business function. The notion of physical collateralization of loans may be foreign to these borrowers, and reliance on non-collateralizing forms of security, such as trust and non-familial co-signatories, has been shown to be defective in other ways. Indeed, the whole cultural device of debt in the western world may operate as an argot that is simply incoherent to the remote villager. There is no FICO score, there is no culture of borrowing to build a home, to build a business, or to fund other capital activities. The regular developed-world consequences of default to which experienced borrowers are readily accustomed (increases in borrowing costs, reduction in available credit, need for remediative plans, eventual bankruptcy) are distantly removed from the quotidian life of the village. The operative components that make the promise to repay so powerful in cultures in which lending has been developed simply do not assert the same kind of importance in the cultures in which microfinance loans are provided.

Indeed, it is somewhat improbable to imagine that remote villagers would themselves conjure up a request for access to credit – particularly on the terms that are prevalent within the microfinance paradigm. It seems at best unlikely that, left to their own devices, borrowers would devise a program of small cash loans, subject to a compulsory rapid amortization schedule at high interest rates, with an uncomfortable system of collateralization and no provision of meaningful productive skills. Quite the contrary, it is conceivable that the whole script of borrowing capital to build up entrepreneurial success can be read exclusively within the language of a western developmental philosophy. This lack of co-authorship is made sorely manifest in the unanticipated and obviously regrettable outcomes such as the violent reprisals that attend a failure to maintain a current status on outstanding obligations. (These outcomes, incidentally, are not dissimilar from certain outcomes in the developed world that emerge when loans are made under pretexts that don't benefit from the full protections of society, such as loan-sharking within organized crime or urban "pay-day" lending programs).

The suggestions that follow target the development of a credit system that is sustainable for lenders and borrowers alike. Through the adoption of these rules, we go much further in addressing ethical demands to respect the borrower as a person, as an end within herself and not as a means only. We treat the borrower with the dignity that is due a person, critical in the promotion of the underlying human rights which (after all) form the background goal of the instrument of microfinance. For any system of credit to be successful, a lender must seek out a borrower with either marketable skills or resources who can utilize capital productively and cover the cost of carry without sacrificing the essence of their dignity or their capacity to produce surplus value. These same principles operate in the most sophisticated corporate transactions just as they do in microfinance. Short of abiding by this ethos, we risk alienating and further impoverishing an entire class of world poor who become trapped in a system of constant credit and unfair indignities as a direct outcome for taking on these loans.

For these reasons, there attaches a minimum duty to create standards within systems of financial intermediation that are coherent with the local borrowing culture. Simultaneously, we must seek to educate and nurture an understanding of the basic preconditions and operative social devices of western lending systems among the borrower base *before* microfinance institutions provide massive and unfettered access to credit in these fragile settings. This pre-loan education could describe, among other things, the importance of deploying funds into capital projects only, the role of repayment in sustaining access to future credit, the consequences of failure, and the method of building sustainable sources of capital.

There are additional steps that can be taken by the microfinance community and its lending institutions to create a more durable cure than the palliative remedy at work today. As a key component to any reasonable system, lenders should establish a bright-line rule prohibiting the provision of credit to borrowers who lack distinct marketable skills or some other kind of non-social collateral. From a normative perspective this is a critical distinction. A borrower with marketable skills – a bicycle repair person, a basket maker, or a small dairy farmer – who is already or could already be accessing primitive rural capital markets through loans from village moneychangers can be dramatically advantaged through the supply of reasonably priced credit. This kind of capital may also lead to the creation of a viable and sustainable system, creating employment and training opportunities for others in the village, enabling small businesses to get off the ground. Microfinance institutions, with their access to highly knowledgeable finance professionals, should not have any difficulty in assessing the business plans that underlie the loan requests. On the other hand, provision of easy credit to essentially helpless people without available avenues of obtaining skills is a recipe for disaster and further impoverishment. Rather than promoting a virtuous cycle of borrowing and capital creation, it asserts a vicious cycle of tempting and wasteful consumption, a scramble for interest coverage, subjection to enormous societal pressure, and a mad-dash to roll the loan with another institution. Because these outcomes are not difficult to foresee, it is appropriate to restrict access to credit to those within a society who are able to demonstrate to some reasonable degree the ability and inclination to deploy the loan profitably.

In the interest of addressing some of the moral hazards of this recommendation, I propose the delivery of this credit through an “asset bank” rather than a cash bank, which would restrict that the funding of loans be denominated in hard assets only, and only for those borrowers who operate at a minimum level of sophistication or capitalization. If a cow is the intended use, *loan the cow*. If a wheelbarrow or a loom, *loan those tools*. This would have a number of practical

consequences. First, few people would borrow a cow if they weren't aware how to use it productively. The same can be said for most productive assets. Paper money, in contrast, is easily alienated; by design it is liquid. This one change would go a long way to ensure that borrowers made use of their loans in some kind of income generating activity rather than use the money for consumption, or for wholesale lending to indigenous moneylenders, or for fraudulent or otherwise disagreeable purposes. Second, the lender would enjoy built-in collateral in the loaned asset itself. This would enable borrowers and lenders to move away from the types of group collateralization systems that have appeared so dangerous and exploitative in many of the ethnographic studies. If a borrower borrows a cow, and fails to make the interest payment, the lender can repossess the cow as something of intrinsic value. As the borrowers grow in their skills and capabilities to utilize these hard assets, they will have more income, more cash flow, and subsequent loans can be advanced against this established income stream as collateral. Although an initial concern might revolve around the impracticality of this idea, I argue that it is precisely its practicality that is most attractive. Because we are talking about small amounts of money, there are very few productive assets that are so complex that they would be hard to obtain or made available by asset banks. For example, it is not as though a microfinance borrower obtains credit in order to place an order for a complex and customizable durable good like a jet turbine. Borrowers who use their loans to obtain productive assets do not engage in any level of specification for the resources they obtain – they are all market purchases. Moreover, microfinance institutions could commit to purchase these resources from local vendors, thereby supporting the rural economy even more thoroughly. Finally, this type of asset-backed lending might provide more adequate feedback to lenders about which forms of rural development are most viable – since they will be able to see which assets are most productive. This should provide important data enabling them to design better skills training programs for future borrowers.

Further, it is critical from an ethical perspective that we break with the model of group-collateralization of loans. Though the initial reaction to the convention of group-collateralization is intuitively positive – if people have no hard assets, and if at least some hard assets are a requirement to collateralize a loan under prevailing lending practices, then we must be unable to rely on conventional methods of lending to advance credit – but upon more serious inspection the workability of this premise deteriorates. Group collateralization fails to respect the autonomy of the individual borrower, unfairly tying that borrower to the performance of another borrower in the loan circle, while also putting the other borrowers in the unfair position of serving as a monitor over the activities of their kin. This unbalanced set of borrower-monitor incentives has been shown herein to have devastating outcomes on the lives of the rural poor. Whatever the gains from group collateralization may be, they are plainly outweighed by the possible negative outcomes that operate in the absence of sufficient background institutions to guarantee legitimate forms of intra-group relations. From a practical perspective, the proposal to eliminate the method of group collateralization is easy to imagine within the asset bank concept: if we lend hard assets out to borrowers and expect payment back in the form of cash, we address the moral hazard issues of relending the money, address the issues of a borrower taking money for something that she cannot use (no one is going to borrow a cow if they can't use a cow) and provide the lender with a hard asset in the first instance, against which they can secure their interest, avoiding the unappealing results associated with attempting to recover monetary sums from indebted villagers who have squandered their borrowed capital due to the easy ability to alienate liquid assets versus non-liquid assets. The features embedded in the asset bank proposal abate the need to rely on peer pressure as a device to recover loans.

There are other mechanisms through which we might reduce the possibility of unforeseen negative outcomes. For example, we could price in insurance at the loan level to protect the interests of both the borrower and the lending institution. Here, a loan would be made to borrowers with a built-in charge for insuring the hard asset in question – if a cow, there would be an insurance adjustment if the cow were to become diseased or stolen. This would protect the borrower in that they would not have the burden of paying interest on an asset that had been dissipated, and likewise would protect the lender against the possibility of non-recovery. After all, insurance is merely a variant method of cross-collateralization, though here implemented in a manner typical of capital markets practices rather than the kind of moral hazard form of micro-finance group collateralization.

All of these modifications to the terms of the loan must be subsequently memorialized in loan agreements. It would be further preferable if the agreements were uniform within jurisdictions, or subject only to pricing modifications such as the interest rate or amortization schedule, as the particular credit risk on a loan might dictate. In this way, borrowers could be instructed about the details of a uniform agreement, so that they could begin to share knowledge with one another as to the importance of certain of the terms. It matters little that many of the borrowers are illiterate – the mere act of uniformly recording the terms to which the parties agree will generate a certain deference to more equal and fair outcomes. Moreover, such a codification would likely reduce the occurrence of those instances cited by ethnographers in which intermediate agents of the microfinance institutions assess untoward fees in an effort to take advantage of borrowers (Karim, *Demystifying Microcredit: The Grameen Bank, NGOs, and Neoliberalism in Bangladesh* 2008). Here, as elsewhere, transparency is a handmaid of fairness. The contract would include, at a minimum, disclosure of risks, borrowing costs (interest and applicable fees), repayment terms, eligible uses of capital, and other relevant aspects of the loan.

Having outlined certain normative considerations at the loan level, it is worth thinking about what additional duties might obtain at the institutional level of interaction, as between the state and the microfinance institutions. Proceeding from a point of view of fair rules of bargaining and the responsibility of a state to protect its citizens against large transnational actors, it appears to be at least noteworthy that in the arena of microfinance the inequality of bargaining parties is radically unbalanced. These concerns derive from the manner in which weak sovereignties have permitted international finance and philanthropic institutions to communicate and bargain directly with some of the poorest citizens in those regions, without sufficient (or any) mediation. This is a sharp contrast to the developed world, where there are few foreign institutions with which a citizen (in the absence of substantial state mediation) might directly interact when situated within the home country. Those transactions through which citizens do directly interact with foreign institutions – for example, the purchase or sale of some good, or the completion of a credit contact – are mediated or supervised by the local government. Foreign companies are forced either to deal through some kind of local or registered agent, or else might be required to set up a local subsidiary, which sweeps the activities of the foreign corporation under the supervision of the domestic legal structure and its background institutions. Conversely, in the case of the rural village in a poor country, where the average person is substantially less educated than that the average person in the developed world, where there is hardly a presumption of literacy or even the necessary nourishment to make valid decisions, the idea that someone in those conditions would be in a fair relational bargaining position to a large and

sophisticated foreign NGO or financial institution is insane. Instead the appropriate approach would be for the state to mediate the relationship on behalf of the borrower, extracting certain commitments from the international organization in exchange for the opportunity to conduct affairs within the state. Thus, the state could assert certain requirements such as the prohibition on the group collateralization of the loans, the limitation on usurious lending rates, the codification of uniform terms of borrowing, as so forth. Although it is a risk that such an intervention might turn away some potential lenders, I do not think it is terribly likely. No one will be surprised that there are certain base rules of the game by which a lender must abide when operating in a foreign jurisdiction – indeed, the real surprising condition is the absence of such rules.

The discordant tone that peals in the background of these prescriptive concepts is the inherent underlying conceit involved in merely airlifting certain successful apparatuses of western civilization directly into developing countries, with minimal deference to the presence of the necessary background institutions (rule of law, cultural force, etc.) that give these apparatuses their force in the western world. Even the “asset bank” idea fails to address certain of the developmental discourse critics who suggest that it is inappropriate to force the desperately poor to prove their worth through borrowing and entrepreneurship. That debate, however, is beyond the present scope of this inquiry. What is clear to me is that the presumably well-meaning application of tested and successful systems from the western world onto the developing world has occasionally worked and has also occasionally wrought disastrous effect.

Notwithstanding my criticism herein, I am inclined to believe that individual access to capital is a critical device to habilitate the poor and disenfranchised of the modern world. It appears to me that the only reasonable tack through which one might disagree would endorse some kind of Marxist or otherwise anti-capitalist dogma, which I cannot hold with. But my personal political philosophy does not lessen the severity of the immediate decree. Indeed, this criticism resonates so loudly because of its urgency, because these practices are afoot today, because the least self-reliant among us are being placed in positions of heightened vulnerability through those very mechanisms that have been devised to achieve the exact opposite outcome. Indeed, based on my research and experience, I consider myself an apologist, but one who is especially open to those criticisms that aim to reconstruct a system that genuinely improves access to fair designs of credit for borrowers. When authors are able to cite that fewer than 30,000 people in the Congo have bank accounts, as compared to 7,000,000 in Belgium, there are clear advantages that attend financial security, freedom, and flexibility. My interest within this paper has been to evaluate certain of the claims that the most negative authors have made, and in evaluating them from an ethical perspective, to discuss what modifications might be made to these most objectionable features, to make them consistently ethical – thereby promoting the overall advancement of microfinance.

But in a very real sense, this endorsement of broader access to capital resources fails to answer the allegations of neo-liberalism that are afoot in so many of these studies. In this way, we are forced to ask somewhat challenging questions that go beyond mere efforts to ascertain whether the provision of capital is generally beneficial, or whether the specific tool of microfinance is adequate in terms of meeting the demands of justice. We are made to inquire whether the manner in which these recompensing institutions have been instituted in divers locales without the parallel establishment of underlying background institutions is itself a somehow unfair or exploitative procedure. By way of analogy, it would be as if we were attempting to drive cars

through the desert with no provision of roads or fueling stations or traffic control devices. Again, these are questions that are beyond the scope of this effort.

At times, the observations of the ethnographic research force us toward a more primal question: why do poor households need to borrow at all? If poverty alleviation is the ultimate goal of these programs, and if the observations of the ethnographers are correct, perhaps we are forced to ask whether a system that is designed on the shoulders of millennium-old established sets of background institutions, namely credit in general, is the right answer for utterly poor borrowers around the world? Should not the demands of justice provide for a non-debt driven distribution of resources? Further research could probe more basic questions of justice: which arguments exactly evoke duties of assistance as intrinsic in the contemporary provision of credit *qua* a form of relief? What types of instrumental justification for (or opposition to) the provision of microfinance obtain, advancing an argument whereby the utility or aggregate good of the world is enhanced (or decreased) by the provision of this capital resource to the villagers around the world? If it is determined that debt is the way to address some of these issues, what are we to make of the clearly negative impact that its presence sometimes causes? Again, these are questions that stretch beyond the present boundaries of this inquiry.

Symbiotic investment in these countries, wherein the capital of the wealthy countries is broadly invested to enhance the infrastructure of the poor, whereby borders of trade are opened, whereby basic human rights are promoted through just economic institutions – these are all desirable goals. The aim of this paper is not to halt the march of foreign institutional capital across the territorial borders of the world. Instead, the aim has been to provide a contribution to the dialogue about how these activities must be structured, in a way that normatively respects the character, decency, and culture of indigenous people, societies, and institutions while simultaneously promoting the growth, stability, and access to opportunity embedded within an efficient and growing system of global capital markets.

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