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Capitalism, Microfinance and Democracy

Sakshi Kharbanda*

Jamia Millia Islamia, Academy of International Studies, Delhi, India

Abstract

The paper looks at the relationship between neoliberal thought of economics and microfinance. Applying the principles of embedded neoliberal economics to microfinance suggests that the government and markets do not exist in solidarity. They can both grow and sink together. Both are required to fulfill each other's requirements to sustain in a nation state. This paper suggests that market oriented economy, can be mediated through the government by bringing in changes to the institutions that can help markets grow and by also molding the nature of relationship it shares with the society. On the other hand, Markets have to incorporate the cultural, social and local knowledge to use it to their advantage. Economic sphere cannot work on its own regulations and by itself completely. The aim of neoliberal proponents shall not be to create same homogeneous conditions wherever they go to operate. Rather diversity should be studied closely to devise the best methods to deal with different contexts and societies. The paper first analyses the relationship between different types of capitals (Physical and Social) with Microfinance and development and then knits them together with the thread of democracy.

Keywords: *Financial Inclusion, Democracy, Capitalism, Neoliberalism, Market, Government*

1. Introduction

Microfinance is an economic, a political process and social process which has made a position for itself in the sphere of development. It is quite evident that it contributes to the alleviation of poverty in developing nations and lays a platform for their empowerment as well. Microfinance has been able to shatter a few beliefs like A) Credit can only be profitably given to economically 'good enough' customers who have access to formal financial institutions and can also pay collaterals. B) poor are not economically viable to 1) become a part of the economic system 2) to carry out their own businesses to make themselves economically independent without being enrolled for subsidized government programs. Unlike other instruments of social and economic change, microfinance has worked on the biggest hurdle for change i.e. cost per person for one's transformation from being under efficient to being economically productive. It has been able to achieve this by studying the diverse environments poor live in and making use of that information to develop suitable products for its clients. Microfinance has wider implications than generally thought of as. It paves way for democratic, social and economic reforms through cooperation between states and markets and civil society. Microfinance has great potential as policy if it is delivered and offered in poor and people friendly way.

2. Literature Review

Rhyne and Otero insist that market oriented approach can also be used to serve the poor clientele as it is used for other usual financial services. What is important is to understand the requirements of the poor and design products accordingly. He also affirms that sustainability of the financial institutions is what makes them capable for such services. Robinson also adds to the same thought by stating that subsidized programs cannot serve large number of people as they are bud-

*Email: sakshi512@gmail.com

get restricted. So does Gonzalez- Vega, he says that external sources of funds are not taken seriously, hence vitality and growth of such programs are not checked upon carefully. So customers are served until external funds are completely exhausted. Best and Conolly emphasized on the importance of different allocations by different institutions. He found how market, state and civil society cater to different needs of the society and how the allotment is done amongst these three is the central issue in a political economy.

3. Objective and Methodology

The objective of the paper is to comprehend the role of three important factors in relation to Microfinance i.e. State, Markets and Capital. The analysis is almost exclusively based on the evaluation of concepts and texts available for Microfinance. The method of analysis is descriptive and the paper desists from making strong conclusions and suggestions.

4. State, Market and Microfinance

Markets can enable the process to reach the poorest of the poor with less effort and cost in the long run than the poverty alleviation programs of the government. Though that does not take away the importance of government regulating and monitoring the multiple institutions that help them achieve their goals and also remove, as much as possible, the impediments to achieve their simultaneous objective of working under the aegis of market as well as make an economic impact. These financial institutions can sustain if market forces work within a framework that depicts social, economic and cultural ideology of the society.

As a neoliberal Karl Polanyi says that economic process is embedded in the non market fabric of the society. This paper tries to look at the powerful merger of a state and market together to reap the benefits that capitalism can provide to achieve a win-win situation for clients of microfinance, providers of microfinance and society as a whole in terms of democracy. He has also pointed in his work that embeddedness between market and nonmarket institutions is important to achieve the economic goals set by the neoliberals. There is a middle path that can be taken. Complete rejection of government is as unsuitable as pure markets. There is a need to have less but strong regulatory authorities to keep the goal of maximum benefits for the majority alive.

There is a relationship between economic parameters and the environment and the context they operate in. Acknowledging the importance of such a relationship leads to better understanding of the diverse policy, values and culture within which production, consumption and distribution take place. Cultures are not considered as hurdles anymore in setting up a credit market or for that matter as reasons for market crash. They, as opposite to the conventional thinking, help realize broader social goals with efficiency. This amounts to acculturation of the market forces and factors in different environments which in turn easily brings in the liberal ideology. It's absolutely necessary to understand the goals from larger perspective and resist from mere objectifying the policy, as doing that also reflects how objectified the subjects have become during the process. This can become an impediment in fulfillment of social goals of pulling poor out of poverty.

The economic order desired by the neoliberals cannot be achieved naturally if markets and political framework would exit in compartments. It's required for them to complement each other and mutually coexist in harmony than as opposing forces. When microfinance is arbitrated through neoliberal principles, it has an impact on state formation, the policies that it makes to regulate and to bring in the market oriented way to reach the poor.

Goal is to reduce dependency on government spending on subsidies and welfare programs and adopt a more market oriented approach with local culture and context in place. This will lead to market based empowerment of its clients. Microfinance is keeping up with the global political economy trends while also being in touch with local context and culture. Microfinance involves multiple stakeholders working with multiple institutions to address multiple social and economic problems. This shows that it has the ability to deepen a democracy and bring about development by alleviating poverty and

reducing inequalities. Microfinance mobilizes poor people towards social change and also empowers them by fostering "alternative modernities[1]". It's important to realize the potential and logic of physical capital as opposed to the power, freedom and other such political discourses. Expansion of physical capital requires accumulation of surplus in a highly diverse environment of developing countries. One has to play with the diversity to turn them to their advantage, without harming the bigger social goals.

Jude L. Frenando's book (2005) describes that accumulation of surplus deals with two kinds of crises and how it manages both of them defines its expansion:

1. Crisis of accumulation: barriers in expansion of surplus due to production issues like inflationary problems, technological issues etc.
2. Crisis of legitimization: when the legitimacy of capital accumulation is in doubt and presents itself in form of economic, political and social crises.

It is difficult to manage these two simultaneously as one leads to another or sometimes the policies used to tackle one is contradictory to the crisis.

He also explains how unequal social and institutional relationships lead to unequal capital development which creates an order for nation states according to their political power. How states manage the crisis and the uneven relationships within the society determine the nature of the state which in turn will have an impact on the outcome of micro finance programs. These two crises, mentioned, above have to be dealt by the state, even when its functions have reduced in both markets as well as society. To produce an atmosphere which is conducive for the expansion of capital, it is imperative for the state to be as close to being a capitalist in nature as possible and simultaneously, be as socially acceptable as possible, as in a consensual democracy opposed to an authoritarian state. This is a very productive scenario for microfinance as state itself creates base for credit markets to operate, with minimum interference in its day to day functioning.

According to Milton Friedman (1982), *"The existence of free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the "rule of the game" and as an umpire to interpret and enforce the rules decided on*."(p. 21)

Milton Friedman (1982) also pointed to the idea of mediocrity if government is the solely carrying out majority of its development projects. It, after sometime can lead to stagnation. Drawing from the same principle we can look at Microfinance programs that are government sponsored, they have not failed entirely but have not been able to realize their full potential also. Economic freedom is a tool that can be used to achieve other political and social freedoms. This indirect benefit of economic independence is still far less important to people than the direct and foremost material benefit that they receive by realizing their true economic potentials.

Microfinance, through economic arrangements and competitive capitalism, disperses the power among many and hence also promotes political freedom in terms of democracy. When individuals in society realize their individual capacity to earn and invest as opposed to just always receive public goods,that's when they become more democratic and more politically aware.

Democracy can eventually be achieved by empowering people economically, by removing gender inequalities and by giving the poor more say in decision making. Economic freedom on individual level gets disrupted by the economic collectivism devised by central planning for welfare of the people. It goes against the principle of personal liberty at least in context of democratic countries. The shift from central planning to liberalism was made because 1) government micro finance plans failed to achieve the target 2) in neoliberal phase it becomes imperative to give in and change the form and nature of state to create conducive conditions for the market oriented way of economic life.

It is also interesting to note that microfinance or finance for that matter involves money as their main commod-

[1] Frenando, L. Jude., (ed.) 2005. Perils and Prospects of Micro-Credit: Neoliberism and Cultural Politics of Empowerment. Routledge Studies in Development Economics, London: Routledge

ity. But this commodity is not a complete physical good which can be produced and sold like other normal goods. That's precisely the reason why it is even more required in case of microfinance to be regulated by the government while being liberal in its approach. It contains fiduciary elements like paper notes, deposits and drafts etc to pay the standardized money or equivalent. It is highly improbable to introduce fully automatic gold standard, which are very costly also, in this case unlike for other commodities. It requires government intervention and governmental action as and when required.

5. Physical Capital and Microfinance

Physical capital in case of microfinance is cited as the one of the main obstacles for development. One would like to invest in any business only if the extra returns exceed the extra costs that are generated during the process. In Milton Friedman's Capitalism and Freedom (1982), he explains that investing in human capital fetches far more benefits than investment in physical capital. It is especially important for the poor and underutilized bunch of talent available in our society.

Jude L. Fernando wrote:

"This means providing opportunities for the poor to unleash their hidden entrepreneurial potential and enabling them to actively participate in capitalist development, and benefit from it. The identity of the poor in development was reconfigured as "new entrepreneur". The explicit message is: we need to bring capitalism to the homes of the poor! Under development is a result of the failures of conventional theories and practices to reach the poor and to understand their social and cultural environments, hence neglect and suppression of their entrepreneurial potential."(p. 17)

There have been many reasons why investments are less likely to be made in human capital and more likely to be made in physical capital. Investor has to incur more administrative cost at a higher risk than it is with the physical capital. Security deposited at the time of providing loan for investing in any physical asset differs considerably from security (in most cases based on future earning) that one would get in investing in a human stock. To compensate for the high risk involved in such type of investments, lenders charge high rate of interest which do not go down well with the borrowers and the usury laws. So, imperfect markets and high administrative cost both repel the investors to invest in human capital.

Here comes the role of the government to intervene in the process to either reduce the cost of the loan by providing subsidies or by regulating the market through imposing ceilings on the interest rates charged by the investors. High subsidies can work only till a point after that it starts to reduce the returns on the investment for the very reason that investors overinvest in such subsidized projects. The cost of the loan should be self paid by the individual himself through his future earnings as this will keep him motivated and burden of the subsidy will not fall on the taxpayers who are not even involved in the project.

Who gets the loan and who does not is also a point of concern especially if able individuals are being excluded from the market for their inability to pay back. This ways inequality in one way or the other would always sustain as there is no equality in opportunity. Microfinance hence provides a very effective tool to solve that problem as it offers loans to small entrepreneurs on a short term first and then their loans are renewed on the basis of merit, that is, if they can pay back the principal amount from their future earnings.

6. Social Capital and Microfinance

(World Bank, 2001)

"Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions. Increasing evidence shows that social cohesion is critical for societies to prosper economically and for development to be sustainable. Social capital is not just the sum of the institutions which underpin a society- it is the glue that holds them together."

To add to the definition, social capital also depicts the strength and benefits that an individual can receive by being a part of the larger sum of individuals and institutions. Social capital makes way for smooth democracy as people decide individually what they want and then

join groups which can help them achieve their individual wants in a collective fashion.

Social capital in case of microfinance helps organize poor small self regulating groups and networks in a market oriented environment. This can be economically progressive as it is based on trust and norms which, if, mingle well with the institutions of capitalism, will generate growth and development keeping the larger good of the society in mind. Nothing depicts the importance of social group better than Joint Liability group started by Muhammad Yunus, founder of Grameen Bank. In that poor women get loans based on 'group guarantee collateral'. This effectively solves three economic problems that banks generally face while providing loans to risky customers

1) Problem of adverse selection – banks fear getting selected by customer who can default while paying back. Group guarantee makes sure that group members select the right partners for the group.
2) Problem of moral hazard – this happens when the information is not distributed among all the stakeholders equally. This leads to unethical behaviors on part of one party which has more information than the other
3) Problem of information symmetry- it's not the pure information that is shared which forms the basis of assumption for neoclassical economics.

Only participating in the group is considered as one step forward for the poor women as they are creating social capital by doing so. Social capital has many implications other than economic progress and political empowerment of the poor especially women. Social capital is accumulated, as opposed to physical capital, not by making changes in the existing institutions but by getting together in form of networks and groups to find a common platform where collective interest can be realized using physical capital. It makes even more sense for poor people as there is dearth of physical capital for them. They can make use of the human capital to compensate for the other. Microfinance is no exception, benefits of networking are known in all spheres of life. Be it business or personal lives of human beings.

Civil society is a product of social capital organized in a way to reap the benefits of market and the government especially when both of them distract from their respective goals. It is a beautiful example of equal and rational individuals coming together for what they think is their right. It is not only the civic organizations and their immediate environments that matter but according to, Michael Woolcock, also matters the banks, markets and the corporate sectors without which it is not possible to attain the higher goals because they are the institutions through which sub objectives can be achieved.

Sum of which can be transformed together by the civil society and other institutes as welfare for all.

Development of capacity at local level can be better achieved by the local people itself than by the collective effort of governments, banks, and other development agencies. Social capital reduces the burden by mobilizing themselves through participatory programs and techniques developed with the help of local knowledge. It also helps neoliberal policy makers to benefit from the association that civil society creates between people and state, which in turn help the creating and accumulation of capital. That's how they become the "agents of their own survival" (Rankin, N. Katherine., Social Capital and Microfinance).

Figure 1 sums up the paper and shows how Dual social and financial mission can not only coexist but can also be mutually reinforcing, if done correctly. Conscious Capitalism, where businesses focus on optimising returns for all stakeholders, most important of them being customers, is the ultimate goal in the long run. Social businesses are also equally desired for creating

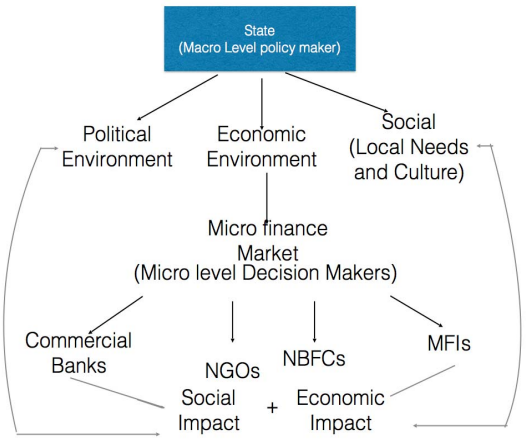


Figure 1. Kharbanda.

social impression as they make sure that impact investment meets its societal goals before it passes it's profits to other stakeholders. Microfinance helps poor crete capital for themselves from themselves.

7. Conclusion

After looking at capitalism from different perspectives in relation with microfinance and given the pragmatic approaches that can be pursued within the neoliberal framework, which has been the main focus area of this paper, to achieve the goals of financial inclusion, it can be saidthat it is possible to make microfinance work through commercialization of the it. This has been repeatedly said in the paper that human capital is as important as physical capital or rather more important to invest in human capital through social capital to create more physical capital. It will attain the ultimate goal of economic and political freedom through the realms of neoliberal policies. It is time for neo liberal thinkers of all genres to understand that government intervention is necessary and it is not possible to evade that. As we are dealing with fiduciary commodity and not the actual commodities, it becomes even more inevitable to run the financial markets without government regulating it. Microfinance requires a central or state agency to see if market is operating in an environment conducive for its functioning. Free markets operating in a democracy must create equal opportunities for everybody to showcase their potential to become economic partners in development. Microfinance is one such development policy which helps poor realize their potential and investors theirs. The crux of the paper is that it's easier, self-motivating and self-sustaining (development sustains for long and becomes an integrated part of the economy if it's coming from all parts of the society and that too on their own) for poor to create capital for themselves, by themselves and to themselves.

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About the Author

Ms. Sakshi Kharbanda is currently a Research Scholar at Academy of international Studies, Jamia Millia Islamia, Delhi, and has done Masters in Economics and Public administration. She Cleared NET (National Eligibility Test) and came in the merit list for Junior Research Fellowship. She is writing her doctoral thesis on Microfinance and Democracy: A Case Study of India and Bangladesh. She is interested in topics like democracy, particularly economic democracy, poverty in South Asia, financial inclusion and neoliberalism. She has presented a few papers on Microfinance and related topics. Her papers include:

1. Presented "Capitalism, Microfinance and Democracy" at SDMIMD, Mysore
2. Presented "Financial Inclusion and Democracy" at Indian Institute of Management, Bangalore.
3. Co- Presented "Water Institutions and Democracy: Are We Paying Enough Heed to The Affected Communities? ", 26th November, University of Dhaka, Bangladesh.
4. Participated in Fourth European Microfinance Research Conference in University of Geneva.

She can be contacted at sakshi512@gmail.com.