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## **From Development Banking to Microfinance: Reflections on the Recent History of Banking and International Cooperation Policies in Latin America**<sup>2</sup>

This chapter provides insights into the scientific and development policy debates about development finance over the last 30 years, with Latin America providing the empirical background. Development theory and policy, including financing for development, are discussed by comparing theories rather than on a regional basis, so that the *general* questions on the development of financial systems and microfinance in the development process and the role of international cooperation stay in the foreground. A second volume with selected articles on rather macro economic subjects with the title: “Dependencia, monetary economics and global responsibility” is to appear to complement the present one. Since these observations are based on a variety of contexts, they may appeal not only to graduate students, but also to those involved with the management of banks and microfinance institutions, development cooperation practitioners, and the general public. This volume thus follows neither strict systematic lines nor a unified style. Instead, it attempts to reflect the different paradigms and suppositions of three decades, the different interests of readers, and, evidently, my personal interaction with the corresponding spirit of the times and contemporaries.

In the attempt to isolate something like a central theme or key notes for the knowledge interest and the analytical view of things in the chronological sequence, I come across, above all, the subject “Development of Underdevelopment” – something not unexpected in 1968 as the year of my first countrywide empirical survey of Colombia (cf. 1970). In contrast to the theoretical mainstream of modernization and growth of the profession, critical economists at that time and up to now have not perceived

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underdevelopment as a backlog that should and could be resolved with capital and technology transfers so that, eventually, even the poorest countries would gradually pass the finishing line to Rostow's mass consumption society. Instead, that research has tried to disentangle the social mechanisms that repeatedly reproduced poverty and authoritarian structures. The fact that capitalism at the periphery of the US as the leading economy can lead both to Western European welfare and to Latin American misery has always challenged and inspired theoretical imagination and empirical investigation. After the fall of the Berlin wall, this question has also gained cardinal meaning for Eastern Europe. It was and is expected that international development cooperation can learn from recent experiences as receivers and as donors when dealing with underdevelopment on the periphery.

From this perspective, an issue which has been especially prominent over all these years is the question whether a fundamentally different economic system is necessary in order to overcome underdevelopment; Whether change need come about through evolution within the dominant social order or through revolutionary, alternative forms of the economy. Therefore, the economic and social developments in Cuba after 1959, in Peru after 1968, in Chile with Frei and Allende until 1973, in Portugal after 1974, in Nicaragua after the *triumfo* of the Sandinistas in 1979, as well as all the utopias and alternative designs of Latin American intellectuals and representatives of popular movements which I have met since my first stay in Colombia as a student in 1963, have provided important inputs for my theoretical as well as my practical work as consultant and co-player in cooperation projects and programs.

The economic results of alternative and revolutionary regimes have proved highly problematic, if not catastrophic, just as their human rights performance, so that – especially after the fall of the wall – even very convinced Latin American leftists like Herbert de Souza in Brazil (cf. 2000) and a revolutionary during the 1990s like Comandante Marcos in Chiapas began to emphasize civil society in their egalitarian discourses pursuing *ciudadania* or *ciudadanía*; that means civil rights as citizens of the state and the economy, in the existing capitalist economic order and in a firmly democratic political order, instead of markedly non-capitalist goals. Only very recently has the banner of socialism been raised again “in the XXI century”, with results still to be seen in the future. Beyond the confines of this new *bolivarianismo*, the way was and is clear for money, financing, banking and credit policies that do not try to fundamentally put politics *against* the market and *against* the laws of capitalism, but rather

takes over the concept of a *social* market economy which can offer the improvement of living conditions of the broad population strata without threatening with fundamental interventions into the order of private property. This volume explores recent experiences from Europe and Latin America in this tradition of a social market economy.

As an established academic since October 1967 in the public service, first as an assistant lecturer for Business Administration at the Economics and Business Administration Department of the Ludwig-Maximilian University of Munich, then as an assistant at the Max Planck Institute for Foreign and International Patent, Competition and Copyright Law, later at the Institute of International Relations SWP in combination with a lectureship for Development Economics at the University of Munich, and finally, since December 1977, as a Professor of Economics and Political Economy of Latin America at the Latin American Institute and at the Department of Economic Sciences of the Freie Universitaet Berlin, I have followed both these alter-native models and the mainstream discussions. In the latter, the core idea is that *not* capitalism, but rather the repression of market forces, namely financial repression, is responsible for the backwardness of Latin American economies. Mainstream research has provided good reasons and empirical research to support these views. A certain convergence of the discussion strands was also just a matter of time. Like Betinho in Brazil, many critics of the mainstream orthodoxy in Germany and other donor countries have turned away from socialism, in its anti-capitalistic varieties and also from the emphatic alternative economics to make peace with social market economics as a normative model. Debate has also turned to ecological matters.

The apologetic orthodoxy, as well as variants of socialism and alternative economics, which I mostly sense as utopian, have always dissatisfied me as a child of re-education in post-war Western Germany and as belonging to the skeptical generation (Helmut Schelsky) of the 1950s. It was thus a happy providence to finally find, during the last 15 years, Monetary Keynesianism of the Berlin School, lead by my colleague Hajo Riese at the Department of Economic Sciences, as a convincing solution for at least some of the puzzles encountered in all the previous years regarding monetary theory, banking, macroeconomics and the political economy of development.<sup>3</sup> After all, according to the rules of economic theorizing,

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<sup>3</sup> Manfred Nitsch: Vom Nutzen des monetär-keynesianischen Ansatzes für Entwicklungstheorie und –politik (On the use of monetary Keynesianism as a base for development theory and policy), in: Schubert, Renate (Hrsg.): Neue Wachstums- und Aussenhandelstheorie. Implikationen für die Entwicklungstheorie und –politik (New Growth

underdevelopment can be seen as nothing else but long-term equilibrium with underutilized resources, similar to underemployment according to Keynes.

My own learning process regarding the support for the financing of the poor is portrayed above all, by what circulates currently under the keyword microfinance. In 1970, I published a case study of Colombia with ideas that soon thereafter became flagellated by scholars of the theory of finance in general as financial repression. Two official, non-published reports (not quoted here) from 1972 and 1981/82 about the German development assistance for development banks in Colombia and other Latin American countries confirmed this diagnosis. They also provided an explanation for why donor institutions face strong incentives to play the game of the other, i.e. local underdevelopment players so willingly, even when successful development effects fail to appear. A subsequent investigation in Colombia about rural finance in Boyacá (1982) demonstrated the deficits of state-run development banks within the framework of one of those integrated rural development programs which were so much *en vogue* at the time. When later a project of the German Society for Technical Cooperation (GTZ) is established in one of the then still positively appearing credit cooperatives, it proves, unfortunately, to be equally vulnerable to underdevelopment practices. Since, in cooperatives, every member, regardless of the value of his or her share, has only one vote, there is typically a lack of ownership incentives, so that management is not sufficiently controlled. A summary of these experiences appears in the publications from 1987 about “Glass palaces and Under-development” and in 1989.

In those times, a rather conflict-laden debate takes place in the Ministry and in the executing organizations in the Federal Republic of Germany, the World Bank and in many other countries, about alternatives to the international support for traditional development banks. Since 1982, I had already taken part in conceiving and structuring municipal savings banks in Peru with support from the BMZ (the German Federal Ministry for Economic Development Cooperation), the GTZ, the National Association of Municipal Savings Banks in Germany, and the Internationale Projekt Consult GmbH in Frankfurt (IPC, formerly “Interdisciplinary” Project Consult) (1987 with Jan Krahn and 1997). I also followed various other reform movements in different parts of the world.

During the 1980s, support strengthened for rotating funds from non-governmental organizations (NGOs), until people realized that, even with a lot of endeavor and commitment on the part of their members, there nonetheless remained a lack of outreach in their fights against poverty. Directed credit with subsidized interest rates and compulsory training (organized by NGOs) turned out to be the wrong alternative to traditional development banking. A policy alternative that covered costs and reached out to the masses mired in poverty still failed to exist. However, some endeavors were emerging that viewed rotating funds as the embryo of a bank, which requires utterly different management principles from the parent NGO, but opens the option of deposit-taking thus contributing to long-term stability and growth. A little later, small farmers from Uraim in the Brazilian Amazon region demonstrated, from the other side, how clever it can be, under inflationary conditions, to found a declaredly financial institution, namely an agrarian *savings bank* (Caixa Agrícola), and then *not* really run it as a bank, but rather as a multi-purpose self-help organization (1992).

In the article on rotating funds (1991), I used for the first time the image of duck feeding, which has become a type of trademark of mine. The background was a walk on the Wannsee lake, where I observed children in the act of feeding ducks and other birds which reminded me of development cooperation projects: no outflow problem for mother's stale bread pipeline; management as easy and pleasant as child play; high acceptance on the receivers' side; every crumb size is possible; and you can change your target group haphazardly. Unfortunately, however, the net energy balance is likely to be negative because the additional wing flap; struggle; and time lost in the search for other fodder has created high opportunity costs for all the birds. Meanwhile, a few get a chance to be the beneficiaries, based on arbitrariness, coincidence, recklessness, or power, enjoying the breadcrumbs that have fallen from the sky. Underdevelopment is thereby reproduced through development assistance – also and precisely with small projects. The alternative explored is – if the reader permits further animal metaphors – the salt-lick, meaning a provision of resources comparable to salt stones, more able to match demand in pasture or forest that cannot otherwise be met, and the use and application of which is not sugar coated.

A type of credit which is in line with market requirements, that is neither loan-shark-like monopolistic nor (half-)received as a gift by a “beneficiary”, as well as other financial services for the target groups in question, can be described as such salt stones. In the 1990s, it was finally

shown that new development finance in the sense of a commercial approach with full cost coverage is possible. Not only in Latin America, but also in Eastern Europe, Africa and Asia, microcredit institutions began to develop on a broad front. Professor Yunus' Grameen Bank in Bangladesh followed similar lines in that they insist in proper repayment and a customer-bank type of relationship instead of beneficiary-donor bonds; avoiding gifts and leniency in repayments.

Some NGO's were ready and able to transform their rotating credit funds into proper banks or other formal finance institutions (upgrading). At the same time, commercial banks started to shift downmarket, sometimes with the assistance of international development projects, establishing special services for small business clients (downscaling). For some state-run development banks the efforts towards reform and downscaling were successful. Finally, some development agencies, support institutions, and consulting firms like the IPC and other technical services providers opened their own micro business banks by starting from scratch. Together with the BMZ-owned German Investment and Development Society (Deutsche Investitions- und Entwicklungsgesellschaft – DEG, recently merged with the Kreditanstalt für Wiederaufbau – KfW), the Dutch DOEN-Foundation, which runs a lottery in favor of development and ecological projects, the Bolivian NGO ProCrédito and IPC employees and managers founding of the Internationale Micro Invest AG (IMI) in Frankfurt (1998) should be mentioned. The IMI was later renamed into ProCredit and has since developed into one of the leading frontrunners in international microfinance.

Starting from scratch will certainly not remain the last word, because many questions regarding development finance in general, and microfinance, in the sense of a comprehensive provision of financial services for lower population strata, are still open. Both analytically and normatively, important questions arise about the delimitation between different actors, namely the state on its various levels, employers and employees, non-governmental organizations, self-help groups, public-private partnerships, private business with socially-oriented investors and profit-oriented businesses. With regard to types of activities, concerns for institutionalizing pension plans, health insurance, and other fields of insurance for the target group of poor population strata also provide new challenges and opportunities. Likewise, international development cooperation still struggles with issues such as consumer finance and debt alleviation for individuals and micro enterprises, and what the call for empowerment and participation, for globalization from below and international networking all

concretely means or should mean also remains open for further discussion. The United Nation Microcredit Summit initiative from 1997 set the goal to provide 100 million families with small credits by 2005. The Monterrey-Consensus emerging from the March 2002 UN conference on Finance for Development, and the Nobel Prize for Yunus and his Grameen Bank in 2007 have given additional boosts. Not only for scientists and academics, but also for politicians, managers, practical economists, NGO's and all the staff working in microfinance institutions: There is still a lot to be done!