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The Economic Philosophy of Micro-Credit System

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Abstract

This paper aims at locating the practice of micro-credit system into a larger theoretical canvas of economic theory and philosophy. A systems theoretic approach has been adopted. Emergence of the 'excluded' class has been explained with the help of the theory of feedback. Individuals have been assumed to be myopic, local optimizer and bounded rational. In this context, the empirical experiences have been viewed and assessed as to their outcomes.

1. Introduction: Micro-credit system attracted the attention of many governments and scholars after the success of the Grameen Bank founded by Muhammad Yunus in Bangladesh in 1983. The micro-credit system extends very small loans to poor borrowers who do not have necessary collateral, steady employment and a verifiable credit history that are needed by the commercial banks or other financial organizations and thus the poor prospective borrowers are excluded from the traditional credit system. The success of the Grameen Bank demonstrated that the inclusion of such poor prospective borrowers into the credit system may prove to be a very powerful approach to alleviate poverty, encourage micro entrepreneurship and boost up economic development, especially of the people at the lowest economic strata. It was also demonstrated that micro-credit system is not based on compassion or charity. It is based on the solid economic principle that the dormant capabilities of the poor (the excluded ones) may be brought to the fore by grouping and realization of such capabilities can sustain itself while also being profitable to the agents who created the conditions for the same. With this instance, many developing countries adopted micro-credit system as a tool for alleviation of poverty. There have been mixed experiences in different areas/countries. Questions on reporting the effectiveness of micro-credit system have also been raised.

The objective of this paper is to place micro-credit system in the larger theoretical framework of economics. Economics is considered as a system of thought that endeavors to explain the evolution and functioning of a society in which every individual seeks fulfillment of his (mostly materialistic) aspirations by exploring, nurturing and exploiting the environment. In this framework, his environment includes everyone else, whether animate or inanimate and it also includes his fellow beings. In so doing, he strives as an individual and if the need arises he forms a group. He is considered to be short-sighted, bounded rational and local optimizer.

2. Society as a self-organizing system: A (human) society is a complex system of a large number of subsystems in which each sub-system is related with the other sub-systems by means of positive and negative feedbacks not only at the same hierarchical level but cutting across the hierarchical levels. That is to say that a sub-system can not only have an access to the subsystems of the same level of hierarchy (sister sub-systems) and through proper channel to the lower level sub-systems (children) under its sister subsystem, but it can also access them directly. This type of accessibility does not make a tree structure, but it has a 'random access' so to say, to other subsystems and their lower order children

subsystems. An individual human being, therefore, is accessed (and can have an access to) several subsystems simultaneously. For facility, these subsystems are called economic, societal, political, cultural, legal, etc. However, this is not limited to human individuals alone. Even a non-human 'individual' such as a tree or a pond can have an economic, social or political connection with 'human individuals' of social or economic organizations.

A society is a self-organizing system whose elements are connected with each other through negative and positive feedbacks passing through the institutional sub-system or the medium of formal or informal rules that punish, prohibit, censor, moderate, modify, encourage, promote or reward the individuals for doing or not doing certain types of acts. In effect, the institutional sub-system tones up or tones down the feedbacks. That is why in some societies two particular elements of the systems may be reinforcing each other while in some other societies they may dampen each other.

Every human individual tries to explore, nurture and exploit his exterior environment in order to achieve his 'local' goals. Here it may be noted that for a human individual all other individuals (human or non-human) and subsystems make his exterior environment. He also explores, exploits and nurtures his interior environment (his own body, mind and ability) to enable himself explore and exploit his exterior environment. Seen in this light, a human individual is only a consciousness, or still more deeply only a will or sole (the words being used due to lack of any other word making the idea easier to comprehend).

While each human individual is striving to achieve his 'local' goal, it is not necessary that he has any idea about his 'global' goal. Almost never he does have any idea of his global goal. That is why it is not uncommon to see an individual striving for a goal for some time and pursuing a just opposite goal after that. These two contrary strivings may be completely conformal to a higher level goal, but the hierarchy of higher and still higher level goals is seamless that does not submit to human knowledge.

This system is self-organizing and the ensemble of this system is under our observation at any moment of time. This is always in flux, changing from moment to moment, under the influence of the dynamical forces that the interactions and the feedbacks shape. It evolves and it has a property to show up emergence or it has a capability to give rise to new subsystems, new relationships, new feedbacks, and so on. At the top of all, this self-organizing system has no destiny, none of its own goals, nowhere it intends to go, nothing it wants to be like. It simply goes on changing itself, reorganizing itself, regenerating itself.

3. Emergence of attraction points: A self-organizing social system naturally gives rise to the point (or points) of attraction. First, it is not necessary that a system should generate forces that are uniform throughout. It is not necessary that all individuals should have one and the same local goal, same perspective, same ability, and so on. It is not necessary that the institutional subsystem should provide uniform transmission of all feedbacks to the connective subsystems nor even that the feedbacks should be uniform and strength or direction wise uniform. Therefore, all social systems experience emergence of multiple points of attraction. These points of attraction initiate a dynamics with positive feedback loop. As a result, some points gradually grow more attractive than the others. Marked inequalities (social, economic, political, spatial, cultural and so on) are observed. In this process, some individuals and subsystems may become marginalized and ultimately turned into an island. This is also called the backwash effect or the external diseconomies of the dominant points of attraction. It may be noted that internal economies (and economies of scale) of the points of attraction feed on the external diseconomies that impinge on the dominated individuals and subsystems. This is a type of exploitation of the environment by the points of attraction. However, if the points of attraction also initiate

nurturing of the environment, the trickle-down effect takes place. Sometimes it may be autonomous and at others it may need human intervention by design.

4. Principles of Exclusion: It has already been pointed out that institutional subsystem or the medium of formal or informal rules prohibit, permit or modify feedback linkages among individuals and subsystems. The institution of private property and wealth is one of such leading institutions. An individual cannot connect himself to some subsystems if he does not have a threshold private property and wealth. His exclusion from a subsystem may snowball into exclusion from some other subsystems as well. In the same manner, belongingness to a social category or a particular region, etc. may be the cause of exclusion.

5. Self-organizing social system and fulfillment of collective aspirations of the people: As it has been mentioned before, every human individual strives to meet his local goal. His goal may or may not be complementary to the goals of others (his environment, including other human individuals). The goals may be competing, sometimes mutually contradictory and at others compromising with each other. The final form of these interacting individual striving for goals at any moment is just like the effects of a gust of wind that moves different leaves of a plant differently. None can predict the movement of a leaf at the next moment. Nevertheless, overall movement may show a tendency, a direction of movement, which of course, may change continuously. This nature of movement, the evolutionary dynamical self-organization of a social system, may or may not fulfill the collective aspirations of people in the society at a given time. It goes without saying that the collective or even individual aspirations are changing from time to time and they are not exogenous to the social system in which they emerge and show up themselves.

Now, for centuries, scholars have been there who believe that the self-organizing social system in general and the economic sub-system in particular will in general fulfill the collective aspirations of the people in a society automatically, even without a conscious efforts made by the human individuals. The collective aspirations are self-fulfilling since the aspirants would automatically choose the efforts such that their collective effects would shape the social system in such a way that the collective aspirations are fulfilled.

But there are others who believe that since the social system does not have its own goals, the collective aspirations of the people in a society may not be fulfilled automatically. The collective aspirations certainly work as feedback to changing other elements of the social system, but since all such feedbacks have to pass through the medium of institutional subsystem, the self-organization of a social system need not reshape the ensemble so as to fulfill the collective aspirations. They also point out that the inertia and the response time of all subsystems of the social system are not uniform. Reorganization takes time and this time may be quite long on the human scale (when viewed in terms of the life span of an individual). It may happen, therefore, that a generation (of individuals) may pass before the social system reorganizes itself to meet the aspirations of that generation. The new generation may be having different aspirations. Hence, the fulfillment of the aspirations of the earlier generation has no charm for the new generation. Therefore, conscious effort is necessary so that the social system fulfills the collective aspirations as quickly as possible. They profess the need to change the institutions, create man-made barriers to automatic transmission of feedbacks, alter the directions and the destinations of those feedbacks, and carry out systematic and guided exploration, exploitation and nurturing, and so on.

6. Recognition of the collective aspirations: Those who believe or do not believe that the self-organizing social system would automatically fulfill the aspirations of the people must admit as to what

are the process and the state of recognition of the collective aspirations of the people. There is, first of all, a lot of value judgment involved in this issue. To complicate the matters further, the value system of a society itself is a part of institutions which are shaped by the people as well as the social system of which they are only a subsystem. There is nothing like a universal value system. There are no value judgments on value judgments because that would lead to an infinite regress.

There are scholars who believe that the society would be better off if the best are given a preferential favor. The brain must consume the most of oxygen that the lungs collect and the heart distributes throughout the physique. If there is a dearth of oxygen, the entire body must collapse except for the lungs that collect and the heart that distributes the oxygen intake of which the lion's share must again go to the brain and a tiny part goes to the functioning of the muscles that support the oxygen supply system and, therefore, survival of the brain.

There are other scholars who would argue that the society is not organized as the human (or animal's) physique, where brain, heart and lungs have a very special location and role for the survival of the organism. Plants also live, but not like animals. The brain, heart or lungs may be distributed over the entire physique. In case of almost all plants, a small twig severed from the plant and planted in a rich soil (sometimes aided with root generating hormone) will take roots and grow into a full plant of its own kind. This is true with the individuals in a society. Each individual can grow to become the best. So, if it is not possible to fulfill the aspirations of all, let the aspirations of the majority be considered as the collective aspiration. Let the majority shape the social system so as to fulfill its aspirations. Hence the dictum: the greatest good of the greatest number.

But, then, each individual is not equally important for the social system to continue, while, on the other hand, the social system is necessary for the individuals to continue. Nor all individuals have the same needs or the aspirations. Some aspirations may be vital both for the individual and the society, but a number of individual aspirations may be irrelevant for the society. Proper weight assignment is necessary. Then, each one must get according to one's genuine need and each one should contribute (as well as receive) in proportion to one's ability.

There are insurmountable problems with all the three dictums mentioned above. In case of the first, who would judge what and who is the best? The notion of the 'best' is highly value-loaded. Ethics and aesthetics are the social products. Ethics and aesthetics are the expressions of the value system shaped by the privileged ones in the society. If the best must get the privilege, then it amounts to say that the privileged must get further privilege. This is simply circular. Turning to equating all and seeking for the greatest good of the greatest number has similar problems. An unprivileged section of the society may not be included among those whose opinions carry weight to shape the collective aspirations. The excluded ones are excluded everywhere, in social, political, economic, cultural, legal and all other spheres, too. For the dictum 'each according to his ability and each according to his need' is marred with the judgmental issue. Who will judge the ability and need? And one must remember that need as well as ability may be socially determined.

Thus comes up the issue of inclusivity. Those who are excluded, those whose opinions carry little weight, those whose preference or deference matter little in the expressed collective aspirations, those who live at the margin, those whose capabilities remained dormant, those whose abilities could not be nurtured, those whose needs remained unaddressed, their aspirations must be brought on the surface and attended to. However, this inclusion need not be based on compassion. Inclusion may be based on exploration, nurturing and exploitation of the latent capabilities of hitherto excluded ones (individuals as

well as subsystems). Once they are included, they would add to the social good more than the cost of bringing them in. The inclusion is socially justifiable, economically justifiable, politically justifiable, culturally justifiable and ethically justifiable.

7. Individual-based and group-based social structures: It has been noted earlier that in the self-organizing social system certain elements (subsystems or individuals) may be connected to the other elements of the system through the feedback relationships via an institutional subsystem. If the institutional subsystem is poorly pervious to the feedbacks, the relationship may be very weak. If the strength of relationship is very weak, it does not satisfy the necessary threshold limit, the relationship is cut off. If the necessary threshold limits are not met with (or the critical mass has never been gathered), the relationships may not emerge at all. Thus, individuals may be left out unconnected to a particular sub-system. This lack of connection may lead to reduction in (or, from the very beginning, the non-emergence of) the relationships (of the individual or the sub-system) with other subsystems, too. This may be due to feedbacks. This may be due to institutional changes narrowing or severing the relationship of the left-out with other subsystems too. Consequently, over time, the individual or the system may turn into an island with unbridgeable large border effects. In short, exclusion may become self-supporting, self-reinforcing and self-intensifying.

Excluded Individuals (or subsystems) may, however, gain an impetus if they connect themselves to make a group. The group formation has economies of network and economies of scope. Due to these economies, the group may satisfy the threshold conditions (or can ensure a critical mass) such that its relations with some subsystems of the social system may become viable. Once this relationship is established, positive feedbacks are sensed by the other subsystems too. And, over time, the group no more remains excluded. The group, and the individual through the group, becomes connected to other sub-systems. This change may percolate to the individuals and in time, the individual may become directly connected to many subsystems of the social system. Bandwagon effects follow. Gradually, inclusion may become self-supporting, self-reinforcing and self-intensifying.

This group formation may be autonomous or it may be designed by a deliberate action of some agents. Group formation may be based on some sort of principle; the principle may be primarily economic, political, cultural (e.g. religious, linguistic), spatial and so on. What matters is the viability of economies of scope and the network effect (and its economies).

It should not be assumed, however, that self-reinforcement and self-intensification processes are linear. Individuals, seeking their self-interest, may ignore nurturing and lean heavily to exploitation of the subsystem. It is here that the Braess paradox comes in. This may start sending negative feedbacks to other subsystems leading to the tapering off of economies of network and those of scope.

It has already been mentioned that human individuals strive for and pursue local goals. They are not far-sighted. It may happen, therefore, that the collective effects of such striving are detrimental to sustenance of the group. It may also happen that finally the subsystem returns back to the individual with the undesired, sometimes contrary, effects of his efforts. What he aspired and strived for goes farther away from him. Therefore, it is not guaranteed that a self-organizing subsystem (that group formation had initiated) should necessarily lead to fulfilling of the aspirations of either the individuals belonging to that group or the community/collectivity that formed the group. Perhaps, here too, human intervention by design may be required.

8. The theoretical foundations of micro-credit system: The foundations of micro-credit system are based on the following premises:

(i) The social system is self-organizing and ever-evolving but it has a tendency to be sub-organized into multiple points of attraction.

(ii) The evolution and function of the social system, under the given institution of private property and wealth, may create a class of the 'excluded' ones who will not automatically be included in the functioning of the system in any significant way and thus will remain underdeveloped and underprivileged.

(iii) Such an 'excluded' class has enormous, but dormant, potential to development and it can sustain its own development. It can also contribute significantly to the larger/dominant system.

(iv) The functioning of the social system with a large class of the 'excluded' is far from being efficient on the measure of productivity as well as welfare.

(v) The evolution, functioning and self-organizing social system is not fully deterministic, but it has a viable scope for deliberate human intervention that may change the course of social dynamics and guide it to attain a better level of optimality than if left alone without human intervention. This can be done by an agent (from within or without). Deliberate human intervention can break the vicious circle of poverty engulfing the 'excluded' class.

(vi) The dormant potentialities or capabilities of the 'excluded' class can be brought to the fore by conscious reorganization and group formation. Group solidarity may release the captive capabilities to realize into gainful activities. The group can easily be joined to the larger/dominant social system and the 'excluded' class may be transformed into an 'included' class. Thus, the group as a whole can prosper on account of the economies of network and the economies of scope.

(vii) Even after the group is formed, the myopia of the individuals may not permit the full potential of the group to realize. Perhaps it requires a sustained and benevolent guidance from some agent.

9. Possibilities of degeneration: Social dynamics, institutional structure, myopia of individuals, etc. may lead to degeneration of the group that is formed to turn the 'excluded' into the 'included' class. There was a time when land ownership (and the resulting power structure) established a relationship of the exploiter and the exploited among the landlord and the tenants. There was also a time when capital ownership established such a relationship. Ownership (or functional ownership) of financial capital that runs the network of micro-credit system may under specific circumstances establish similar relationships when the surplus created by the micro-borrowers is fully exploited by the 'financial capital lords'. A power structure may emerge that coerces the borrower until his ruin or crushes the sugarcane until the last drop of juice is extracted. The exploited individual is ensnared in the cobweb of debt such that he cannot come out even if he wishes so. This degeneration may be state supported. After all, the state is an expression of power and it always works in favor of the dominant class interest.

10. Empirical experiences: It has already been mentioned that the micro-credit system had experienced an exemplary success in Bangladesh. The Grameen Bank (Bangladesh) is the largest and most famous organization dedicated to microfinance in the world. Its 8.4 million active borrowers (of which 96 percent are women villagers) received more than \$1 billion in loans during the year 2010 (Attali, 2011). In India, NABARD, that is active in developing financial inclusion policy, finances hundreds of banks to on-lend funds to self-help groups (SHGs) that have 20 or less members, mostly women from the 'excluded' classes. In 2014 (March), there were 74.29 thousand SHGs with a total savings of Rs. 9897.4 crore in which Rs. 8012.89 (80.96%) crore was due to the SHGs exclusively for women. A total loan of Rs. 24017.4 crore was disbursed of which 87.59% was extended to the SHGs exclusively for women. Women form a special 'excluded' class and the role of NABARD in alleviating their economic condition is especially appreciable. Al-Mamun et al. (2010) report a positive impact of microcredit schemes on the

hardcore poor client's quality of life in Peninsular Malaysia and conclude that expanding microcredit services to more people will improve the quality of life of the hardcore poor households and, therefore, usefulness of the microcredit program as a development instrument is appreciable. Atapattu (2009) concludes that although it is difficult to state as to what extent microfinance has contributed to national poverty alleviation in Sri Lanka, but there are enough circumstantial evidences to conclude that it has contributed to decline of poverty. For Pakistan, Latif et al. (2011) conducted a case study and found that micro credit has positive impact on alleviation of poverty and about 40% of the beneficiaries (under the case study) opened shops/small provision stores, followed by investment in poultry, embroidery and livestock. As summarized by About Microfinance (a portal of microfinance) Lapeneu and Zeller (2001) found that the majority of microfinance institutions of the world are in Asia. This continent recorded the highest volume of savings and credit, and served more members than any other continent. East Asia is particularly well served by micro-finance institutions. In terms of gross national product, Bangladesh, Indonesia, Thailand and Viet Nam had the highest loan volume. In contrast, India and the People's Republic of China, have very low outreach. Countries such as Afghanistan, Myanmar and Pakistan also have low outreach due to a variety of factors (About Microfinance).

Yet, there are reports that do not go so well. For Burma, Turnell (NA) observes "microfinance could fail ... and continue in the dismal tradition of Burma's financial sector - of just another idea, good in theory and well-intentioned, gone wrong in application." There are critics (Neff, 1996) who hold that microcredit did not have any positive impact on gender issues, it has not alleviated poverty to any notable degree. It has led many borrowers into a debt trap some of whom committed suicide (Banerjee et al., 2014).

A few conclusions drawn by Banerjee et al. (2014) are worth reproducing. They conclude: Microcredit may not be the "miracle" that it is sometimes claimed to be, although it does allow some households to invest in their small businesses. ... does affect the structure of household consumption investing in durable goods and restricting their consumption of temptation goods and expenditures on festivals and parties ... it affects labor supply choices - households that have access to loans seem to work harder on their own businesses. Banerjee et al. (2014) further conclude: "Thus, microcredit plays its role as a financial product in an environment where access is limited, not only to credit but also to saving opportunities. It expands households' abilities to make different intertemporal choices, including business investment. The only mistake that the microcredit enthusiasts may have made is to overestimate the potential of businesses for the poor, both as a source of revenue and as a means of empowerment for their female owners."

11. Conclusion: As it is expected, the effectiveness of micro-credit system in changing the status of the 'excluded' into the 'included' ones crucially depends on a number of factors. First, did the disorganized class of the 'excluded' happen to get an efficient and benevolent agent who could organize them into a group and was able to bring out their dormant capabilities to the fore so as to channelize them into productive/entrepreneurial endeavors? Secondly, did the individuals in the group have solidarity or they still continued with their myopic view and predatory instincts unmodified and unbridled? Thirdly, did other group loyalties (such as those based on cultural principle, etc.) cut or did not cut across the group solidarity on account of micro-credit based principle? Lastly, did the institutional structure allow or not allow the feedbacks to connect the micro-credit based subsystem to develop relations with other subsystems? Many of these may not be under the control of either the benevolent agent or the members of the 'excluded' class. Further, it is always difficult to change a '*class in itself*' to a '*class for itself*'; it is not easy to inculcate class consciousness and recognition of class interest.

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