UNDERMINING SUSTAINABLE LOCAL ECONOMIC AND SOCIAL DEVELOPMENT WITH MICROFINANCE: EVIDENCE FROM CROATIA

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Abstract: The international development community has increasingly positioned microfinance as one of its most important poverty reduction, local labour market and local economic and social development policies. The enormous appeal of microfinance is based on the widespread assumption that simply providing access to credit will automatically catalyse poor individuals into entrepreneurial activity, thereby establishing a sustainable ‘bottom-up’ economic and social development trajectory based upon rafts of new and expanding microenterprises. However, it is increasingly coming to be recognised that such claims for the power of microfinance are actually backed up by very little solid empirical evidence. In this paper we report on a survey of the microfinance sector in Croatia. Our results suggest that the microfinance model has actually undermined the chances of sustainable economic and social development in Croatia.

Key words: microfinance, sustainable development, Croatia, poverty reduction, microenterprise, informal sector.

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1. Introduction

As is well known, by the early 1990s, the concept of microfinance had risen to the very top of the international development community’s poverty reduction, local labour market and local economic and social development policy agendas (Armendáriz de Aghion and Morduch, 2005). Microfinance is seen as a major breakthrough in poverty reduction and ‘bottom-up’ development policy alike. Particularly within today’s neoliberal-oriented IFIs, perhaps in the World Bank above all, microfinance is a ‘wonder intervention’ that all countries simply must adopt.

However, every so often there comes along an idea that is simple, seems to work very quickly and it ‘feels good’ – but yet is fundamentally misconceived (for example, see Dichter, 2003, and Easterly, 2006). Such ideas quickly rise to prominence, but then embarrassingly the idea falls out of favour when it eventually becomes clear that it is actually destroying far more of value than it is creating. Is microfinance the latest example of this phenomenon? We ask this rather provocative question for three inter-related reasons. First, there is an increasingly yawning gulf between the hugely optimistic narrative promoted by the microfinance ‘industry’ and its many supporters, and the quite contradictory and messy reality increasingly being reported on the ground (for example, see Rogaly, 1996; Bateman, 2003, 2007a, 2008; Lont and Hospes, 2004; Dichter and Harper, 2007). Secondly, when we look closely at those countries having successfully engineered sustainable development and poverty reduction since 1945, especially in the case of the most recent episodes of rapid growth (such as in East Asia since 1970 and Latin America since 2000), why is it that the ‘new wave’ microfinance model is conspicuously absent from the narrative everywhere (Friedman, 1988; Weiss, 1988; Wade, 1991; Amsden, 2007; Chang, 2007) and, moreover, those local financial systems that did play a crucial role in these important historical episodes were all pretty much the complete opposite of the highly commercialised model of microfinance so popular today - that is, community development banks, financial cooperatives and the like (see Bateman, 2007b). Third, it is uncontroversial to report that the preferred ‘new wave’ microfinance model is almost perfectly in tune with the neoliberal policy agenda: in fact, ‘new wave’ microfinance is really just local neoliberalism (for example, see Bateman, 2008). We find this fact discomforting, however, because there is much evidence to show that the IFIs place such a huge premium on promoting the dominant ideology (i.e., neoliberalism) that they are very often willing to legitimise and support manifestly inefficient institutions simply because of their ideological serviceability (for example, see North, 1990). Does microfinance in any way fit into this category perhaps?

This paper is a contribution to the ongoing critical re-evaluation of the microfinance model, with Croatia the focus of the enquiry. With more than ten years of microfinance activity in Croatia, it should now be possible to identify and evaluate some of the most important microfinance impacts and trends that have emerged here. Based upon the operation of microfinance in other areas we first established a number of simple hypotheses concerning how microfinance might work in Croatia. With these hypotheses in mind, a data gathering exercise was undertaken in 2007 involving the three MFIs currently operating in Croatia. Several data collection methodologies were used. First, a semi-structured questionnaire was designed to provide background data on the operations, strategy and impact of all three MFIs. Second, follow-up interviews were arranged with all three Directors of the three MFIs in Croatia to confirm earlier
data and impressions and to explore a little more some of the key issues that had arisen. Third, a random sample of 30 of the current clients of DEMOS successfully completed a semi-structured sample survey instrument by telephone interview.

2. Background to microfinance in Croatia

Croatia was one of the last of the countries in South East Europe after 1990 to accept the microfinance paradigm, and even then it was only a hesitant acceptance. Its background of relative industrial, commercial and technological success within the former Yugoslavia (along with Slovenia) was seen as an endowment that implied no comparability with poor non-industrialised countries, such as Bangladesh. Having largely moved away from its informal sector past in the post-1945 era, many Croatian government officials taking office after independence in 1991 were reluctant to effectively sanction a return to a policy that relied on the proliferation of developing country-style informal sector microenterprises. Instead, rightly or wrongly, the main emphasis was on saving the best of the large-scale enterprises inherited from the former Yugoslavia, which required technical support and financial resources that were in very short supply at the time, combined with a concern for the SME sector.

The main developments in Croatia with regard to microfinance therefore actually took place as part of the reconstruction and development activity following the end of the Yugoslav Civil War in late 1995. Three MFIs were established in the post-conflict zones (Areas of Special State Assistance) of Croatia. Their aim was to address the issues of endemic poverty, dramatically high levels of unemployment, collapsing social capital/solidarity and severe intra- and inter-community regional marginalisation. MikroPlus was established in 1995 as an NGO operation. It was initially promoted by Catholic Relief Services (CRS), which was then providing a number of forms of local support to the post-war reconstruction effort in Croatia. It received an initial financial donation from USAID of around $US750,000. Following a $US3mn donation by USAID, NOA was established in 1996 as a Savings and Loan Cooperative (S&L) to work in the war-affected eastern region of Croatia around Osijek. NOA very quickly expanded out of its original base around Osijek, however, establishing branch operations in Pakrac, and then later on in Dubrovnik too, thanks to a further $US1mn USAID donation designed to help the reconstruction of tourism in Dubrovnik in the aftermath of the Kosovo conflict in 1999. Finally, DEMOS was founded in July 1999 by the International Catholic Migration Commission (ICMC), and registered in July 2000. Its main technical support was provided by Mercy Corps. It initially received a donation of $US585,000 from the United States Bureau of Population, Migration and Returnees (BPRM). In 2001 it received a further $US682,000 donation from USAID’s Economic and Community Revitalisation Activity programme (ECRA). Initially based in the town of Karlovac, within a couple of years it had opened a branch office in the Western Slavonia region as well.

3. Analysis of the impact of the three MFIs in Croatia

3.1. Microenterprise failure rates

A critical characteristic of the informal microenterprise sector everywhere, but particularly in developing and transition countries, is the very high rate of failure.
(Maloney, 2003). In general, high rates of microenterprise entry are typically offset by high rates of exit in a local ‘job-churning’ process that signifies little new net employment creation. Moreover, high rates of failures are often associated with poor individuals being plunged into even deeper and longer lasting poverty, indebtedness, marginalisation and insecurity.

**Hypothesis 1:** Microenterprise failure/exit rates in Croatia are high and suggest little real net employment generation, and they will also precipitate a fall into even deeper poverty, indebtedness and insecurity for those failing.

All three MFIs refused several requests to provide contact details that would have allowed the construction of a representative sample of former clients, which in turn could have been used to ascertain how many clients actually failed since the MFIs establishment, why they failed, and – crucially - what then happened to the individuals involved in terms of their poverty status. Clearly, the issue of microenterprise (client) failure was an extremely sensitive area.

With its small number of larger clients, NOA claimed that of the 350 new microenterprises it had financially supported since 1996, ‘probably around 300 were still in business today’ (today being May 2007). If true, this would appear to be a reasonably good track record compared with, for example, EU SME development programmes (see Storey, 1994). However, bearing in mind the size of the enterprises supported – nearly all, in fact, were SMEs rather than microenterprises – this raises the interesting notion that NOA is actually no longer an MFI but has transformed itself into a small business bank already.

In the case of both DEMOS and MikroPlus, however, the situation was much more complicated. It was pointed out that with so many clients operating in very simple areas, such as street selling or ‘one-cow’ dairy farming, the concept of ‘business failure’ effectively has little meaning. Clients generally continue working no matter what happened to the investment made with their microloan. If the investment fails to generate an income, then typically they return the microloan from the earnings derived from some other business activity, from another microloan, out of savings, and so on. In addition, both DEMOS and MikroPlus also provide many microloans for ‘household business activities’, and here too there is little meaning to ‘failure’ since (a) it is not possible to say that a household ‘failed’, and, (b) the microloan is most often used to purchase consumption goods.

However, it is possible to define ‘failure’ in such a way as to best describe what actually happened to the microloan received. We can define ‘failure’ as being the case where an investment is no longer being used for the business activity it was originally meant for. We received strong indications from the telephone survey involving DEMOS clients that the microloans provided involve very high failure rates. Of the 30 DEMOS clients interviewed 10 were using their funds simply for consumption goods purchase. Of the other 20 clients, their microloan was used to purchase an additional cow, in a few cases two cows. The interviews revealed that half of this group had ‘failed’ in the sense that they were now being forced into selling off the additional cow(s) bought with their microcredit, largely because they simply could not earn sufficient income to cover their costs and realise a surplus as well. In the case of the other 10 ‘surviving’ DEMOS clients who reported that they were able to keep the
cow(s) purchased with the microloan, these clients added that they were just about surviving. Margins were extremely low, while pellet feed, veterinarian services and other inputs were increasingly expensive. Crucially, however, they added that they were only ‘just about surviving’ because, on DEMOS’s advice, after purchasing their additional cow(s) they had immediately been able to enter into the Croatian government’s dairy subsidy programme. Pointedly, all but two of the 20 DEMOS clients in this dairy group reported that they had only been able to survive and repay their microloan (with half eventually ‘failing’, as just noted), because they enjoyed the government subsidy.

We also found evidence to suggest that microenterprise ‘failure’ is an important factor in precipitating a decent into deeper and longer lasting poverty. Clients interviewed all indicated that they were struggling to repay their microloan and some were using cash from other personal sources to do so, thus using up personal assets that could provide a hedge against future problems. Half reported that ‘failure’ with dairy cattle had led them to lose long-held assets (e.g., savings, family property), incur additional debts and lose also local social reputation. It was clear, therefore, that their overall situation was now appreciably worse than before they accessed their first microloan. Moreover, half of the clients interviewed reported that they were ‘only just surviving’ thanks to the Croatian government’s subsidy programme: otherwise, they too would most likely have abandoned the assets (i.e., cows) they originally purchased with their microloan.

3.2. Displacement issues

Displacement occurs when a new or expanded enterprise displaces an equivalent amount of employment or income in another enterprise that either fails or simply contracts. In many microenterprise development programmes, given the local focus of their activities and under conditions of stable local demand (exogenously determined), significant displacement effects are very likely to be associated with microfinance. In developing countries, Davis (2006: 182) reports that displacement dynamics in the growing informal microenterprise sector have precipitated declining average incomes and increasing poverty inter alia because, “(the) space for new entrants is provided only by a diminution of per capita earning capacities and/or by the intensification of labour despite declining marginal returns”.

Hypothesis 2: ‘Saturation’, displacement effects and the ‘fallacy of composition’ dilemma combine to ensure that microfinance Croatia will achieve little real net employment or average income-raising impact. New entry in the most ‘saturated’ localities will simply precipitate the gradual reduction of average incomes/margins for already struggling incumbent microenterprises.

The MFIs in Croatia were aware of the issue of local market ‘saturation’ and displacement, since an earlier focus on small traders as clients was abandoned when it became clear that most were collapsing (and therefore were a risky client). But the turn towards supporting clients in the dairy industry instead appeared to be as problematic. In the Karlovac region it was very apparent that the local dairy market was showing clear signs of ‘saturation’. With hundreds of new tiny dairy farming units popping up thanks to DEMOS, incumbent dairy farming units began to experience real difficulties finding local buyers at prices that would cover costs. There
was much evidence that the displacement of tiny dairy producers, especially those supported by DEMOS (i.e., the very smallest units), was a major local dynamic. Moreover, in spite of such adverse conditions there was no discouragement to further entry, which might have established an equilibrium from the supply side. Instead, normal local market stabilisation processes were prevented by DEMOS, which continued to encourage additional new entry of small-scale milk producers for non-market reasons (i.e., its own survival reasons), of whom most were then only able to survive because, as they were advised by DEMOS, they managed to tap into Croatian government subsidies. In addition, the local over-supply factor naturally encouraged the two regional milk purchasers to take steps to rationalise their local supply chain, weeding out the most marginal producers – again, most of these being established with the support of DEMOS.

It was also clear that measures undertaken by the MFIs in pursuit of financial survival give rise to simple and significant displacement effects. For example, the 2003 move by DEMOS into the consumption lending field (by 2004 more than 50% of DEMOS’s microloans were simple consumption loans), and later by MikroPlus as well, generated strong displacement effects within the local consumption credit provider sector. The rationale advanced by DEMOS for their major strategic move was quite simple: consumption lending was very profitable. And even though the city of Karlovac was served by at least three other exclusively consumption lending-based local financial institutions (savings and loan cooperatives), of which at least one (Duga) was located no more than 30 metres from the DEMOS main office, it was still considered strategically important to make such a move. However, it is very likely that displacement effects are going to be high here too, and thus genuine additionality created by the new DEMOS market move minimal at best.¹

3.3. Deadweight issues

Deadweight effects arise when a project (e.g., establishing a microenterprise) is undertaken regardless of the stimulus provided by an outside body. Here this means that a microenterprise is either created or expanded regardless of the fact that a microloan is obtained, or where the microfinance element is but one component of an overall financial package. For example, Rippey (2007:106) reports on surveys in Bangladesh showing that microcredit often accounts for no more than 10% of the total funds gathered over the year by poor households, asking how it could be that, “microcredit transforms households in struggling economies when it accounted for such a small fraction of their financial strategies?”.

Hypothesis 3: MFIs provide microloans to facilitate microenterprise entry and expansion in Croatia, but the amount received is not decisive to entry or expansion, leading to very minimal additionality.

Many of the microenterprises in Croatia routinely obtain additional capital from more than one source. In one MFI, NOA, it was a matter of policy to ensure this. It was explained by NOA that a feature of their current and future growth strategy is to

¹ MikroPlus were also becoming more interested in consumption loans, but by 2007 only 10% of its microloans were in this sector.
increasingly take a small financial position in larger projects, rather than provide 100% of funding for smaller microenterprise projects. This strategy was arrived at within NOA in order to minimise risk and to allow NOA to benefit from scale economies – that is, larger projects achieving optimum scale and having adequate capitalisation are more likely to succeed than those struggling to reach scale and acquire sufficient capital. However, taking a small stake in a larger project may well be a financially advantageous from the point of view of the MFI, but this confers little if any additional development impact generated within the community. To the extent that subsidiary financing becomes a main operational feature of NOA, its developmental value within the community is reduced significantly and deadweight diseconomies come into play.

Several of the DEMOS clients interviewed maintained that they collected funds from a variety sources, especially their own and extended family savings. If a microlon was simply ‘top-up’ funding, then it would have had little impact. We have now view on this issue given the paucity of the data obtained. However, the telephone survey revealed that in those cases where internal funds (savings) were limited, many DEMOS clients found the microlon was the crucial factor in them being able to establish their microenterprise. Several interviewees mentioned that the two MFIs were willing to accept guarantees that the commercial banks or anyone else would not accept, so that the MFI was the only source of credit in practise. Thus, we might conclude that deadweight effects are not very pronounced, meaning the MFIs provide a source of capital that might not be available elsewhere. This advantage of microfinance might be an important factor in otherwise credit-constrained communities.

3.4. Scale issues

For all enterprise sectors there is an accepted minimum efficient scale of production, below which it becomes increasingly difficult to be competitive. Very often this involves simply the necessary use of a modicum of technology to ensure low unit costs. It might mean a particular machine is required, rather than a more labour-intensive technology, in order to ensure both low unit costs and reaching a minimum quality threshold. However, the structure of microfinance generally ensures that supported microenterprises are well below the minimum efficient scale for their particular sector. MFIs promoting the entry of large numbers of tiny and basic microenterprises largely refuse to register the crucial importance of scale within sector. The end result is the entry of large numbers of microenterprises all with very little chance of becoming competitive in the sector within which they operate, at least without deploying compensating strategies of self-exploitation (low wages, long hours, poor conditions, etc). This dilemma persists in spite of the fact that poor people have long recognised that the scale of any operation they undertake will determine its likely success.2

Hypothesis 4: The proliferation of below minimum efficient scale microenterprises in Croatia will damage the overall chances of poverty reduction and local economic

2 For example, ROSCAs (Rotating Savings and Credit Associations) spontaneously emerged in many poor countries at least partly in order for the poor to pool their cash in order for much larger business projects to be established.
development through adverse market dynamics, hyper-self-exploitation and other adverse scale-related developments.

The data provided very clear evidence of adverse scale-related market and poverty dynamics being created by microfinance in Croatia. In particular, DEMOS’s focus on the dairy industry appeared to have seriously damaged the chances of sustainable development dynamics arising in the region. As noted above, thanks to the ‘artificial’ poverty-push entry of below minimum scale producers supported by DEMOS, raw milk prices were low, contracts were insecure (because suppliers routinely failed), and milk quality difficult to maintain (with so many market participants continuously coming and going and with too-small producers unable to afford testing and other machinery). Also as noted, both regional dairy processors have finally begun to restrict their purchases of milk to larger and more scale-efficient dairy operations. Worse, at the time of the telephone interviews (May-June 2007), the minimum collection had just risen to 100 litres daily (and both dairy processors had recently announced that the minimum delivery amount will ‘in the near future’ rise to 200 litres). Several telephone interviewees responded that had had to break off their deal to supply one or both local dairies since they simply did not have the herd size required (6 to 7 cows are required to secure a daily output of 100 litres of raw milk). Some were still managing to supply through increasing their herd on their own, or linking in with other small local producers (who delivered milk to each other before the dairy processors called), but only just. All relevant telephone interviewees registered their strong feeling that this development was effectively going to mean ‘..the end of the line for them’. Finally, it was clear that those dairy producers with the potential to become efficient were unable to invest their way towards higher productivity because market share was insecure and prices low, plus local financial institutions other than the MFIs (e.g., local banks) would not provide funds precisely because of the adverse market dynamics and artificial over-capacity in the dairy sector. Thus, both the known strategic imperatives involved in promoting an efficient dairy industry, and the Croatian governments own attempts to promote a more efficient dairy industry, were undermined because of microfinance.

It is extremely important to note here that it is perfectly clear to most agricultural specialists that the issue of achieving scale is perhaps the single most important barriers prohibiting the sustainable growth and development of the dairy sector in Croatia. For example, a major survey of the dairy sector by Agropolicy (2005) concluded that,

‘..as far as the economics and development of milk production are concerned, Croatia lags far behind the EU Member States. Most Croatian milk is produced on family farms and that production is expensive and insufficient to meet the needs of the dairy industry. There are a large number of small farms (2.8 cows per farm on average) with poor production capacities, 10,000 of the farms producing only 6,000 litres each per year (23).

The Croatian government has thus been strongly encouraged to use its limited financial and other resources to urgently rationalise the dairy sector in order to reach EU standards and be in a position to effectively compete against EU dairy sector producers and processors. This rationalisation process urgently needs to ensure that,
‘The farms which are not market oriented (presently almost half of the all milk farms) (. . .) disappear while bigger farms with modern technology (. . .) develop’ (5).

Importantly, bearing in mind the need to coordinate policy across sectors, the Croatian government also needs to ensure that,

‘Agricultural policy initiatives should encourage only those programmes which will ensure the long term survival of this sector in a competitive market and/or those programmes which ensure some desirable social benefits’ (5).

In other words, the core recommendation provided by the above experts, and other specialist studies too, is for scarce financial and technical resources to be brought to bear upon the dairy industry in order to rationalise the sector, *principally on the basis of rapidly achieving minimum scale in dairy units*. The activities of DEMOS in this regard are, therefore, quite clearly frustrating the efforts of the Croatian government, the EU and others, all of which are seeking to establish an efficient dairy industry in Croatia, with all the benefits that this would entail for the economy as a whole.

In complete contrast to the approach of both DEMOS and MikroPlus, NOA started its own micro-lending activities very much with an idea to avoid scale diseconomies in its client base. NOA’s main technical assistance provider in its early years – Opportunity International – had initially proposed that NOA provide microloans up to a maximum value of $3,500. However, USAID was the other main supporter of NOA and the source of its starting capital (a $3mn donation), and they had a different idea. USAID advised NOA to provide microloans up to $10,000 on the basis, apparently, that ‘nothing much below this will have any impact’. Accordingly, NOA emerged with a quite different approach to both DEMOS and MikroPlus, in that right from the start it was veering towards becoming a small business bank rather than a straightforward commercial microfinance provider.

### 3.5. Sectoral/structural issues

The sectoral or structural composition of a local economy is an important determinant of its future sustainable growth and development. Countries like Germany, the UK and Italy in the 1800s first developed a critical mass of small-scale industrial enterprises before beginning to build upon this foundation to establish the large industrial enterprises and combines that established them as the world’s leading industrial nations. As Alfred Marshall (1919) famously noted, it is the entry, expansion and gradual *agglomeration* of small and medium-sized industrial enterprises that created the conditions upon which the larger industrial enterprises might eventually emerge. A crucial developmental role has been performed by small-scale *industrial* enterprises in most developed economies. Even more so in the contemporary era, small-scale enterprises are at the core of today’s innovation and technology development processes, providing a crucial ‘bottom-up’ industrial development dynamism that both catalyses and integrates into the operations of larger industrial enterprises (see Braczyk *et al*., 1998). It should also be noted that in many transition economies there remains a significant endowment of ‘mature’ technologies,
institutions and industrial structures that are a good basis for diversification into new production and process technologies through small enterprises.

**Hypothesis 5:** Microfinance in Croatia will promote a local economy structure based mainly on microenterprises possessing no productivity growth or technology upgrading potential, thus creating a ‘poverty trap’ of its own making. This will be come more acute to the extent that local resources (e.g., local savings) are ‘locked in’ to be constantly reinvested back into microenterprises through the intermediation of local MFIs.

It is well known that the MFI sector in Croatia is primarily associated with the establishment and expansion of the very simplest of microenterprises. The data showed that two of the MFIs operating in Croatia – DEMOS and MikroPlus – are particularly strongly associated with the promotion of very simple rafts of new microenterprises. However, we found little evidence to suggest that any sort of real foundation for future growth was being established: on the contrary, a crucial externality generated by microfinance in Croatia is that it undermines the activities of many sectors attempting to become efficient: for example, the dairy sector. Certainly very few of the dairy sector-based microenterprises themselves have any real future, and we noted that any current poverty reduction impact is wiped out by future failure/contraction that takes with it accumulated savings, assets and other resources.

NOA is something different from both DEMOS and MikroPlus in that it appears to specifically target microenterprises and small enterprises with at least some growth potential. This seems to be helping to build a cluster of microenterprises and small enterprises with a reasonable chance of becoming a platform for future sustainable growth. Of course, this risk aversion behaviour might simply reflect a desire to carefully maintain the value of the initial SUS 3mn donation so that when the initial employees and some others eventually become shareholders of a new private commercial savings bank, as is their stated desire, the new bank will have a significant capital asset upon which to begin profitable operations.

### 3.6. Social capital issues

New wave’ MFIs are increasingly straight-forward private profit-seeking businesses and, as with any private business operating forced to operate in a highly competitive market framework, they will not be able to avoid undermining and destroying local social capital (i.e., local volunteerism, goodwill, trust, cooperation, solidarity). Rather than focus upon what might genuinely reduce poverty, ‘new wave’ MFIs inevitably turn towards satisfying the core priorities of its two key active stakeholder groups – its senior employees/founders (key goals – continued well-paid employment, maximising financial return, accumulating power and prestige) and its shareholders (key goal - maximising financial return).

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3 The most egregious recent example is that of Mexico’s microfinance bank, Compartamos, which started as an NGO but thanks to the careful actions of it founders and some of the local friends, it transformed them into multi-millionaires while charging its clients – mainly poor women – over 100% yearly interest rates. Some have termed Compartamos the microfinance industry’s very own Enron.
Hypothesis 6: Microfinance will destroy local social capital/solidarity, especially as MFI s move away to realise the goals of insider stakeholders and, eventually, outside shareholders.

We found strong evidence to suggest that all three MFIs are challenging, if not destroying, social capital in their respective localities. First, in common with MFIs elsewhere across the world (for South East Europe, see Bateman, 2008), all three MFIs in Croatia have gradually moved to take advantage of their non-governmental independent status to work towards an increasingly internal, private agenda. Both DEMOS and NOA are planning their conversion into a commercial bank which will, among other things, likely see insiders financially benefit to a considerable degree through enhanced salary packages, shareholdings, and so on. At the same time, it is clear that the original financial support provided to the MFIs by the international community is effectively being privatised into their hands as well. For example, NOA’s planned transition to a commercial bank will effectively gift its new owners (i.e., its initial employees and some key clients) the original $3mn donation given ‘to help the wider community’. We found some evidence to suggest that this development is already undermining NOA’s position of trust and goodwill within the local community. The increasing commercialisation of the three MFIs is creating some unease with clients as well. In the telephone interviews, several interviewees relayed their strong feeling that DEMOS was increasingly becoming ‘like a businesses’ by charging unclear up-front fees and monthly membership subscriptions on top of providing loans at what they considered to be very high interest rates indeed (all three MFIs charged fees in order to overcome the 12% interest rate cap imposed by the Croatian government, claiming that they would not be able to survive otherwise). Moreover, it is also important that two of the three MFIs – DEMOS and MikroPlus – have moved significantly away from their original developmental mandate and have switched their operations quite significantly into consumption lending. This move was dictated, not by any desire to promote development from some new angle, but simply because of the low risk/high profit associated with consumer lending operations. This self-interested trajectory represents a major loss of international and local funding and institutional capacity within the local community, and a separation of the MFI from the local community.

Overall, by first engaging with poor communities in Croatia under the watchful eye of the donors, and then effectively abandoning their primary concerns in favour of internal considerations (survival, financial gain), Croatia’s MFIs are increasingly looked upon with an increasing degree of cynicism, mistrust and suspicion.

4. Conclusion

This paper has reported on an ongoing research project evaluating the real sustainable economic and social development impact of microfinance in Croatia. It is clear, first of all, that the MFI sector in Croatia is professionally very well managed and that local staff are dedicated and professional in their work. Notwithstanding, our results strongly suggest that as development institutions the MFI sector in Croatia has achieved very little indeed in terms of underpinning sustainable local economic and social development trajectories. Worse, it is actually likely that the three MFIs have actually undermined the chances of a locally sustainable development trajectory from
emerging. Particularly with regard to the issue of what type of microenterprises are the result of their work – too small, wrong markets, unskilled, no technology, etc – it is possible to say that such an emerging foundation is highly unlikely to facilitate the building of a sustainable local economy, but more likely to permanently block it. At the very least, therefore, and bearing in mind significant future EU funding for local/rural financial sector interventions, if there is to be any hope of finally establishing sustainable local economic and social development trajectories in Croatia it would seem that a new generation of local financial sector concepts and initiatives are urgently needed.

Put very simply, the microfinance model has generated a set of ‘initial conditions’ that because of path dependency have given rise to an increasingly backward local economic and social foundation. In Croatia, as elsewhere in both the developing and transition countries, the MFIs have been strongly encouraged to reach high levels of efficiency as increasingly commercially-focused institutions in their own right. But the objectives they have then followed, especially most recently, have been seriously at odds with the sustainable development goals and objectives of the Croatian local economy and society. We therefore tend to agree with Douglass North (1990), who argues that the neoliberal institutional framework, of which ‘new wave’ microfinance is an increasingly important element (Bateman, 2008), has reproduced a set of negative local incentive structures typical of developing countries, ensuring that,

‘The organizations that develop in this institutional framework will become more efficient – but more efficient at making the society even more unproductive and the basic institutional structure even less conducive to productive activity’ (North, 1990; 9).

Moreover, these negative local incentives are likely to become even more powerful and destructive in Croatia, given that the three MFIs examined here are all aiming to expand their operations through the mobilisation of local savings. In effect, more of the community’s valuable surplus resources in Croatia will end up being locked in to the sort of sub-optimal, MFI-mediated ‘local savings and investment cycles’ that we have identified. We therefore find few optimistic portents in the possible extension of microfinance in Croatia.

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