The informalisation of the BiH economy and the role of the microfinance model

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Economic Policy Research Unit (EPRU) Seminar

“Balkan economies: Studies on Non-Standard Phenomena”

September 26, 2006
UNITIC, Sarajevo, Bosnia and Herzegovina.

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1. Introduction

“One recalls how Western professors (now senior colleagues of the current crop of advisors) went out to Japan and Korea during their rapid growth spurts, telling policymakers that they could expand ever so much faster if they would just liberalise their systems. They were politely received – and their suggestions ignored. Will the leadership in possibly stagnating postsocialist systems have the courage to follow similar nonliberal convictions?” (Lance Taylor, 1994: 48).

The microfinance model now constitutes the most important local strand of the neoliberal political project that has been enforced as core economic policy throughout developing countries since the early 1980s and in the transition economies since 1990. The World Bank, IMF, the major bilaterals (especially USAID and the UK government’s Department for International Development (DFID) arm), and the wider non-governmental international development assistance community (e.g. Oxfam), have all become convinced that establishing commercially sustainable micro-finance institutions (MFIs) represents an important breakthrough in poverty reduction and local economic and social development, if indeed it is not the twentieth century’s most important development innovation. Poor individuals just require regular access to small amounts of loan capital via MFIs, the argument runs, and they will be able to start their own micro-business, generate income, accumulate assets, extend their education and skills, maintain their personal health, and, perhaps most importantly, grow their microenterprise into an SME or an even larger enterprise. As Jeffrey Sachs (2005) related in his recent book explaining how to reduce world poverty,

“At the most basic level, the key to ending extreme poverty is to enable the poorest of the poor to get their foot on the ladder of development. The ladder of development hovers overhead, and the poorest of the poor are stuck beneath it. They lack the minimum amount of capital necessary to get a foothold, and therefore need a boost up to the first rung”.

1 A shorter version of this presentation is forthcoming as a chapter in Thomas Dichter and Malcolm Harper (eds) What’s Wrong with Microfinance?
2 For example, see the comments of Chowdry et al (2004: 291).
Eventually, it is widely claimed, this ‘bottom up’ market-driven development trajectory will lift whole communities, localities and countries out of poverty and under-development (for example, see Otero and Ryhne, 1994; MCS, 1996; Robinson, 2001; Armendáriz de Aghion and Morduch, 2005).

With perhaps as much as $100 mn of international funds channelled into establishing MFIs in Bosnia and Herzegovina (BiH) since 1996, the microfinance model was very deliberately positioned as the central policy component of BiH’s post-war community-based reconstruction and development effort. Leading the way in BiH was the World Bank with the Local Initiatives Project (LIP), a $40mn programme of long term financial and technical support geared to establishing a number of independent commercially sustainable MFIs across the country. Alongside the LIP came a large number of other microfinance programmes and investments involving other international agencies (e.g., EBRD, UNDP, UNHCR), bilateral bodies (e.g., KFW) and international NGOs (CARE, Mercy Corps). Importantly, both the network of LIP-sponsored MFIs and the many other MFIs entering BiH all effectively had to follow the market-driven operating rules now defined by the IFIs to be ‘best practise’ – this is to say that MFIs must above all else prioritise becoming financially self-sustainable through ‘earning their keep on the market’ (Drake and Rhyne, 2002).

In spite of specific reservations as to the microfinance model’s applicability in the industrialised, institutionally rich and quite sophisticated market-based economies that arose from the dissolution of Yugoslavia (i.e., including BiH), the initial optimism appeared to be more than justified very early on. Newly functioning MFIs and their international sponsors in BiH quickly began to report many thousands of new microenterprises, new jobs and many satisfied individual microfinance clients whose desperate plight appeared to have been addressed. A new post-conflict local microenterprise-driven dynamic seemed to have taken root in BiH, in line with the example supposedly set by post-communist Poland after 1990. And, crucially, thanks to the commercialisation imperatives adopted in the MFI sector, it seemed that all this

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progress was being achieved at very little cost long term cost to the international community or to the BiH government.

The international community almost immediately began to classify the microfinance model in BiH as one of the main international examples of microfinance ‘best practise’. As the main initial promotional force behind the microfinance model in BiH, the World Bank recorded its LIP programme as its best development programme in the country, and the LIP thenceforth became a mainstay of its microfinance promotional material across both the developing and transition countries alike. Microfinance lobbying bodies financially supported by the World Bank, and (therefore) fully in agreement with its neoliberal policy perspective, such as the Warsaw-based Microfinance Centre (MFC), began to pick up on and publicise the BiH experience right across the transition economies. And specifically with regard to the post-conflict reconstruction and development context, the very widespread feeling was that, as Nancy Barry of Women’s World Banking put it,4

"Any war-torn country should look to Bosnia as a role model"

I would argue, however, that this narrative of unqualified success in BiH is largely based on a mirage. It is, in fact, constructed upon a self-serving and constantly moving admixture of unconvincing assumptions, disingenuous use of ‘outlier’ individual case studies, unwarranted extrapolations derived from individual short run outcomes, and the deployment of highly dubious ‘client versus non-client’ impact evaluation methodologies. There is, actually, a gaping absence of genuine, independent studies mapping out the longer term aggregate impact of the microfinance model, in BiH or anywhere else.5 Moreover, given that the longer run poverty reduction and economic success of the developed economies now providing the bulk of the financial support and policy advice to BiH was not based on anything

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4 Quoted in Dolan (2005).
5 Even analysts sympathetic to the microfinance model concede that very few independent studies have been done that might illuminate its precise longer term sustainable impact, as opposed to its very immediate (but possibly just temporary or reversible) impact on the microloan recipient. For example, Chowdry et al (2004:293) note that, “...on labour markets, capital markets, social capital and participation, conflict and the macroeconomy, the record is virtually silent”.

close to the microfinance model, but effectively its antithesis, the very basic question of the overall appropriateness of the microfinance model in BiH (and everywhere else, but especially in reasonably industrialised countries) remains moot. Providing some answers to these questions is vitally important for BiH policy-makers currently formulating meaningful policy responses to the increasing economic difficulties the country now faces.

This paper thus aims to briefly explore some of the core aspects of the operations of the microfinance ‘industry’ in BiH since 1996. I first take issue with a number of assumptions that have been routinely aired in BiH since 1996 in order to underpin the legitimacy of the microfinance model. I then consider a number of areas where the microfinance model is particularly vulnerable in BiH in terms of its assumed association with sustainable economic and social development.

2. Some background to the situation in BiH

Following the end of the Second World War, a Soviet-style central planning model was immediately adopted in the new Socialist Federal Republic of Yugoslavia. However, for a number of reasons, the central planning model was abandoned as early as 1948. In its place came the worker self-management system operating within a broadly (sometimes more, sometimes less) market-based economy. The new worker self-management system was initially a major success. It was quite decisive in very quickly reconstructing Yugoslavia after the Second World War, and in thenceforth fashioning Yugoslavia into one of the world’s fastest growing economies in the 1950s and on into the 1960s (see Horvat, 1976). For a number of years during this period, Yugoslavia was actually the fastest growing economy in the world - the Balkan precursor of the famous ‘Asian Tiger’ economies that emerged in the early 1970s.

However, in the early 1970s an increasingly marginalised Yugoslav Communist Party attempted to register a come-back. It introduced a raft of very complicated

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6 Excellent treatments of the extensive set of state-coordinated policy interventions, carefully planned industrial and financial sector innovations and long run state investments that actually lie behind developed economy success, including the successful reconstruction of western Europe and Japan after 1945, are Weiss (1998) and Chang (2002). In terms of sustainable microenterprise and SME development, Weiss’s (1988) work on northern Italy remains an excellent examination of a highly successful local state-coordinated development policy.
bureaucratic procedures upon the enterprise sector, which were intended to re-politicise enterprise decision-making. Once employees could see that they were now no longer in broad control of their enterprise, however, levels of worker participation fell, motivation declined, and productivity began to collapse. Combined with a major oil price hike in 1979, the new procedures succeeded only to undermine the worker self-management system. A period of economic and political crisis ensued. However, rather than being transformed into a more efficient and genuinely democratic economic system in line with the wishes of the majority of Yugoslavs and the then Yugoslav government, under pressure from the IMF and key western governments and their advisors, by 1989 the worker self-management system was forcibly consigned to the history books.

The BiH economy prior to 1989 developed quite rapidly under worker self-management. By the 1980s it was comprised of a mixture of large industrial units using reasonably modern technologies and exporting to many countries, particularly to the Middle East. At its core was a very substantial military-industrial sector producing for the Yugoslav Army, as well as for clients in many countries; again, very much including the Middle East. BiH also had an agricultural sector composed of mainly small units that provided a fairly high degree of food self-sufficiency (around 60% in the pre-conflict period as opposed to 11% in 2004) and important additional local income possibilities. BiH possessed an SME sector that was in the process of beginning to react positively to the new investment, technology and trade opportunities opened further in the 1980s (see Bateman, 2000). In terms of technology and innovation, BiH was making real progress in several sectors, notably in engineering and construction where nearly 500 companies were operating in BiH before the conflict generating around 7% of GDP. The economy of BiH thus stood in a reasonably good position in the late 1980s to take advantage of the upcoming changes and likely advent of new technologies, innovations, investments and market opportunities.

Any initial transition progress was very quickly interrupted, naturally enough, by the break-up of the former Yugoslavia and the subsequent outbreak of conflict in 1992.

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7 See Woodward (1995)
8 See World Bank (1996).
When a peace agreement was finally concluded in late 1995 with the signing of the Dayton Peace Agreement at the Dayton Airforce Base in the USA, the BiH economy was in a pretty desperate state. Much of the infrastructure was destroyed, many factories abandoned and equipment left to rot, unemployment was endemic, poverty was at painfully high levels, social capital was all but destroyed in many communities, and inequality was quickly heading towards Latin American heights. However, the international community immediately set into motion a major reconstruction and development package, one that on a per capita financial basis was to prove to be in excess of the Marshal Plan that helped Western Europe successfully reconstruct after 1945.\textsuperscript{9} Alongside the financial aid was a package of technical assistance from the World Bank, IMF and various other foreign economic advisory teams that helped the new BiH government unroll the standard neoliberal package of policy reforms.

Very quickly after the Dayton Peace Agreement in late 1995, the international community launched the microfinance model in BiH as well. It was positioned as the centre-piece of a comprehensive programme of international support for immediate poverty reduction. With a large population of refugees and Internally Displaced Persons (IDPs), an exhausted social welfare system, massive unemployment and tremendous poverty, clearly something needed to be done, and fast. Large-scale public works programmes and state-coordinated (but internationally-financed) investment and employment generation programmes were rejected as possible solutions. While such measures had played a considerable part in the very successful reconstruction of Western Europe after 1945 (see Eichengreen, 1995), especially the substantial innovation-driven SME recovery and development programmes initiated by sub-national government structures in northern Italy and in the then West Germany, the ascendant neoliberal project meant that such policies were, no matter how effective, simply not politically feasible in 1995. Instead, microfinance was considered the most politically appropriate - i.e., market-driven - way of helping the poor find their own solution to poverty and under-development.

\textsuperscript{9} See CFER (2000).
It was also expected in 1995 that the microfinance model would play a crucial role in establishing the institutional foundations necessary for the longer run ‘bottom up’ growth and expansion of a microenterprise and SME sector. An expanding microenterprise and SME sector would quickly constitute the dynamic core of a revitalised BiH economy. The best and most technologically astute SMEs would quickly (re)integrate into the operations of those local large enterprises able to re-start after the war, as well into the operations of the large multinational companies expected to arrive in the near future and large enterprises located abroad. Most other SMEs and microenterprises would begin to satisfy less complex local market demand patterns. Since many items consumed in BiH during the conflict had had to be imported, it was also assumed that a considerable amount of import-substitution would help to stimulate growth in the local microenterprise and SME sector.

Although the microfinance model was very quickly incorporated into the economic policy framework adopted by the first post-conflict BiH government, it was not done without some resistance from the BiH political establishment. The microfinance model’s intimate association with a range of developing countries that were all finding it difficult to point to obvious local economic and industrial success in the wake of huge quantities of microfinance, such as in Bangladesh and Bolivia, raised some real suspicion in BiH policy circles as to the likely outcome of the microfinance model in BiH. The uneasy feeling was that perhaps the main international sponsors behind the microfinance model had in mind for the BiH economy a similar non-industrial, largely informal economy future.10

In order to combat any possible local resistance to the microfinance model, therefore, the IFIs felt it had to use the familiar combination of ‘carrot and stick’ policies used elsewhere in the transition economies. The ‘carrot’ was the possibility of funding for major microfinance projects alongside serious financial support for other important government programmes. The ‘stick’ was the threat of not funding the BiH government and its programmes. Just to be doubly sure that the correct policy message was taken on board by the BiH government, however, the IFIs also took

10 This point was articulated a number of times during discussions the author had with senior government personnel, academics and local employees of several international organizations during a research visit in 1998, and then also in February, 1999, on the sidelines of a major conference on the microfinance model held in Sarajevo.
steps to ensure that all possible alternative local development models were blocked. For example, a number of proposals for an SME Development Bank put forward by some of BiH’s best economists, which would have focused on supporting relatively sophisticated and technology-intensive small enterprises seeking to build upon BiH’s not insignificant industrial heritage, were consistently derailed (see Bateman, 2003). Indeed, such was the importance of the microfinance model being accepted and operationalised in BiH that the IFIs also routinely moved to prohibit even basic discussion of possible alternatives, such as local industrial policies. Those professional economists and others in BiH with the likely temerity to interpret any data or international experience in a way unfavourable to the prevailing IFI-imposed conventional microfinance wisdom were deliberately, but without fuss, largely kept away from local consulting contracts, evaluation missions and IFI-financed research programmes.11

For a time, the initial optimism surrounding the microfinance model seemed to be justified, however. Very quickly after 1997 it became obvious that very many new microenterprises were kicking into operation right across BiH, a good many of them established on the basis of the microfinance model. Streets were increasingly lined with shops and kiosks selling second hand clothing. Throngs of individual sellers offered new and second hand items that they had purchased in bulk from elsewhere in the Balkans and beyond. In most towns one particular locality became quickly known as the place where shuttle traders were offering their goods, including a rapidly growing amount of imported goods from China. Families with no other asset or income source but their small plot of land - which was a large number immediately after the war – were now selling small amounts of surplus produce in the local farmers market or simply on the street. Cafés, bars, fast food outlets were multiplying very fast. Small boutiques selling branded (and often counterfeit) western fashion goods quickly became ubiquitous. Handicraft shops and souvenir sellers emerged to

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11 One of the IFI’s main institution-building tasks in BiH following the conclusion of the conflict in late 1995 was to establish a local neoliberal policy elite able to influence domestic economic policy by ‘pushing from the inside’. Those willing to sign on to the neoliberal project were then consistently supported in a variety of ways. At the same time, the fear of being seen to be critical of the IFIs, and then possibly losing out on valuable local consulting and research contracts, was usually enough to encourage self-censorship of any ‘awkward’ research findings. Such actions on the part of the IFIs have, of course, been very common right across the transition economies, involving both local and international consultants alike (for example, see Wedel, 1998).
meet the demand arising from the large international presence in BiH. As Matul and Tsilikounas (2004:458) saw it,

"Markets (in BiH) were flooded with goods after the war, many people were producing bread, growing cows or chickens but did not know where to sell their goods given the large level of available supply and market saturation. Many refugees were selling clothes that had been imported from Hungary and had to sell them for very small margins due to high competition”

The statistics began to corroborate what was becoming increasingly visible on the ground. The number of new microenterprises and SMEs was indeed quickly climbing. The UNECE estimated that in 2001 there were 78,400 registered self-employed individuals and sole proprietors in BiH (UNECE, 2003; 93), a sizeable increase on the (albeit highly tentative) 1996 figures. In spite of being registered, however, most of these units remained outside of the tax, social contributions, and other systems associated with the formal economy. But the numbers of incorporated microenterprises and SMEs also increased too, as shown in Table 1.

Table 1. Total number of incorporated enterprises and partnerships in BiH

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>0-9 employees</th>
<th>10-49 employees</th>
<th>50-249 employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>30,200</td>
<td>25,600</td>
<td>3,380</td>
<td>1,020</td>
</tr>
</tbody>
</table>


The expansion of the microenterprise and SME sector in BiH had some fairly distinct and inter-related characteristics.

First, it was quite clear that the overwhelming majority of the new entrants were operating in the informal sector. The result was that the informal sector quickly became a much more significant component of the BiH economy than it had before the conflict. Some of the impetus for this came from the new commercial MFIs. All of the new MFIs in BiH began with a commitment to support only registered
microenterprises, based on an understanding that an officially sanctioned expansion of the informal sector was a negative development for BiH and so to be avoided. But when it became clear to the MFIs that the overwhelming majority of their potential clients were already, or planning, to operate informally, financial self-sufficiency imperatives dictated that this requirement had to be quietly dropped (see Goronja, 1999). Thus, essentially in order to secure their own survival, most MFIs thenceforth heavily engaged with the informal sector. Moreover, it turned out that the informalisation trajectory was not just an immediate post-conflict phenomenon, as some initially suggested would be the case, but an accelerating one. The most recent studies in BiH, for example, indicate that the informal sector is strengthening its hold upon the BiH economy. Informal sector employment has risen from 37% of total employment in 2001 to 42% in 2004,12 now bringing BiH gradually into line with the majority of developing countries.

Second, the overwhelming majority of new entrepreneurial initiatives established in BiH after 1995 involved very simple easy-entry business activities indeed. The main areas of business were, as noted above, cross-border shuttle trading, internal trade, small-scale retail outlets (kiosks, boutiques, cafes), very basic services (repairs), simple ‘manufacturing’ (e.g., handicraft production), and the small-scale processing of agricultural items for local sale. Many of these simple ‘survival’ activities were already well underway during the conflict, especially small-scale agricultural production for local sale or barter, helping the non-combatant populations on all sides to survive.13 The end of the conflict allowed many such small-scale entrepreneurial activities to move up a gear. Thus, partly spontaneously and partly thanks to the growing direct assistance of the microfinance ‘industry’, the microenterprise sector that began to emerge in BiH after the conflict very much resembled a typical developing country mercantilist ‘bazaar’ economy, as shown in Table 2.

Table 2. Sectoral distribution of SMEs in BiH

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade</th>
<th>Manufacturing</th>
<th>Construction</th>
<th>Services</th>
<th>Other</th>
</tr>
</thead>
</table>

12 See World Bank (2004)
13 Bateman (1994).
Third, the overwhelming majority of new entrants have been of the microenterprise variety, with relatively few SMEs getting started after 1996. Most MFIs preferred, at least initially, to channel their funds into the very smallest enterprises. One other reason for the dearth of new SMEs, however, was that most international community financial support was targeted at the small number of still functioning SMEs able to demonstrate a reasonable track record of pre-conflict operations.

Fourth, while the rate of microenterprise entry has been impressive, so too has been the rate of exit. Exit rates began to rise very quickly after the conflict ended, as very many initially promising business ideas were registered but quickly came to nothing. The rate of displacement was high, especially in retailing. The legal sector raised much of its income helping businesses register and obtain property by sale or lease, and then helping them back out of the deal a year or so later when the business crashed. Later on, too, when the economy appeared to be settling down after the initial post-conflict boost, the rate of exit was still significant. For example, the World Bank’s 2005 evaluation of its LIP programme pointed out that 30% of the microenterprises surveyed in 2002 had failed after just two years (Dunn, 2005:22). The World Bank-EBRD administered BEEPS Survey in 2005 found that after two years 23% of its original panel of SMEs could not be re-contacted because they had closed down.  

Essentially, the ‘poverty push’ nature of much new entrepreneurial activity, coupled with terminally weak Business Development Services (BDS) institutions in BiH, meant that very many unskilled and ill-equipped individuals unwisely entered the very basic activities they knew they could easily handle, but which so could just about everyone else.

By the end of the 1990s, the BiH economy remained in a very parlous state. Very little substantive economic development had taken place since Dayton. Nor were there very many optimistic portents suggesting that the situation would change for the

| 2001 | 45% | 18% | 9% | 12% | 16% |

Source: UNECE (2003: 95)

14 EBRD (2005)
better in the short to medium term. The industrial sector was continuing its precipitous decline, sources of longer term investment capital remained in very short supply locally,\textsuperscript{15} and unemployment and poverty were still painfully high. The international development community in BiH finally began to sit up and take notice. Apart from anything else, the deteriorating economic situation meant that the delicate post-war political accommodation the international community had helped to broker at Dayton in 1995 was coming under real threat. More widely, EU integration was also in danger. An economically unstable BiH would act as a block on the accession of countries further east, and also undermine Greece’s economic, political and transport links to the heart of the EU. Internationally respected economists with an in-depth knowledge of the region, such as Branko Horvat from Croatia, also increasingly began to point to the poor record of reconstruction of BiH (and Croatia) under the tutelage of the IFIs. When compared to the Keynesian inspired post-1945 Western European reconstruction period, and the very successful post-1948 reconstruction of Yugoslavia under worker self-management (Horvat, 1999), the current policies were clearly not performing as predicted.

In 1999 the EU/Bosnia-Herzegovina Consultative Task Force, a policy co-ordinating body established in June 1998 by the Council of the European Union, convened a working group to develop an urgent industrial policy response to the worsening situation in BiH. It was particularly worried about the rapid decline of the existing industrial sector and its associated institutional fabric, as well as the almost complete lack of new private industrial SMEs.\textsuperscript{16} Local industrial policies had actually been emphasised by local experts for a long time after 1995, the Consultative task Force noted, and also promoted by many international analysts too. But by and large the IFIs considered such ideas to be anathema, and so blocked their adoption. The report led to some new programmes of more targeted support being announced, but no real substantive changes were forthcoming in terms of the (neoliberal) policy framework within which BiH was expected to recover and grow into the longer term.

\textsuperscript{15} Worse, the new private commercial banks were mobilising local savings across BiH and mainly ‘investing’ them in the Western European banking system – see Čaušević (2002),

\textsuperscript{16} Press release of the European Union, Sarajevo, 16\textsuperscript{th} February 1999.
An increasing number of assessments now began to describe the economic situation in even starker terms. By 2001, for instance, the international governing body for BiH, the Office of the High Representative (OHR), was describing the economic situation as “dire”. In the same vein, the UNDP (UNDP, 2002) bleakly reported on the chances of there being a sustainable economic and social development trajectory in BiH now that the population had effectively been,

“...condemned to reliance on a grey, trade-based, unsustainable economy rather than a production-based one”.

A detailed report by the independent European Stability Initiative (ESI) found an alarming number of bad economic indicators, suggesting to them that the BiH economy was in a pretty desperate state. Summarising the ESI report, the US-based and US government financed Centre for International Private Enterprise (CIPE) was forced to concur with the proposition that economic policy in BiH had effectively led to,

“Bosnia ()going through a process of de-industrialisation on a devastating scale. The new private sector is dominated by microenterprises in trade and basic services, generating very little employment. Bosnia seems to be developing backwards: where once it manufactured jet aircraft, it now exports aluminium; where once it exported furniture and finished wood products, it now sells only raw timber. Outside of the larger cities, many Bosnians are abandoning the towns and returning to the land their families left a generation ago. Forced out of the formal economy, they scrape together a living through some combination of casual labour, informal trade and subsistence agriculture”

Initial IFI predictions that by simply unleashing brute market forces in post-conflict BiH a sustainable recovery would automatically be vectored into place, thus proved to be as naïve and wildly inaccurate as in the rest of post-Communist Eastern

19 See CIPE (2004:2).
20 For example, see World Bank, European Commission and EBRD (1996); World Bank (1997).
Europe. At the same time as most developing countries have been desperately trying to move up the technology and industrial ladder, the previously quite highly industrialised and technically sophisticated BiH economic structure has effectively been allowed to collapse. The reasons for the current malaise and record of decline since Dayton are many and complex, of course, with the unstable political arrangements emerging from the Dayton Peace Agreement a key factor. But this is not the whole story. I want to examine here what has been the role of the centrally positioned and hugely supported (financially and politically) microfinance model in relation to the current unsatisfactory situation. Perhaps, the microfinance model has very usefully slowed down and ameliorated the worst economic and social aspects of the overarching process of decline and informalisation; perhaps it played a wholly neutral role; or perhaps it helped it along its way?

3. Key assumptions underpinning the microfinance model in BiH

In seeking to establish the microfinance model as the core poverty reduction and local economic and social development intervention after 1995, and later on as a major success story, the IFIs came to heavily rely upon a number of basic assumptions to back up their preferred storyline. It is therefore quite useful, first, to challenge the validity of these widely propagated assumptions, many of which are now resurfacing, again unchallenged, in other post-conflict zones across the world (e.g., Kosovo, Iraq, Afghanistan, Lebanon). Although there are others, I think three assumptions have been of particular importance in shaping the microfinance debate in BiH.

3.1. Assumption 1: MFIs are eventually going to be financially self-sustaining, so the local enterprise sector and local economy in BiH must benefit from their continuing ability to provide microfinance to any microenterprise that wants to use it.

A universal assumption in the microfinance ‘industry’ is that if an MFI is financially self-sustaining, then the local enterprise sector and local economy simply must stand to benefit from the presumed increase in the local supply of finance (for example, see

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As Andor and Summers (1998) explain, the “Transition Depression” that took place in nearly all the post-communist Eastern European economies after 1990, particularly hard-hitting in Poland and Russia, was a complete surprise to all of the international financial institutions, key western governments and high profile international economic advisors.
Robinson, 2001). Even if entrepreneurs find the terms and maturities involved in most microfinance programmes pretty onerous – typically, high interest rates and very short repayment periods – microfinance is nevertheless a better and more popular option than either informal sector money-lenders or going without financial support completely. Accordingly, the primary goal of any MFI should be to make sure that it is financially sustainable: the subsequent economic and social impact of the financial support it disburses is a given.

First of all, it is not at all clear that most MFIs can be financially self-sustaining, in BiH or anywhere else. In fact, a lot of the emerging evidence tends to suggest that most MFIs are in fact not financially sustainable (for example, see Mosley, forthcoming). On careful investigation, it turned out that even the iconic Grameen Bank example is based upon the receipt of not insignificant amounts of Bangladesh government and international donor community subsidies (Morduch, 1999).

It is also important to clarify what it means by becoming ‘financially sustainable’. This is because in many cases the financial sustainability goal is achieved only by an MFI shifting into completely unrelated areas of work – that is, it ‘survives’ but it is no longer an MFI as originally conceived. In BiH, for example, many of the pioneering MFIs are already shifting quite significantly into new market segments. Generally this has involved moving ‘up market’ into less risky and more financially lucrative areas (e.g., housing loans, consumer loans, SME loans backed by collateral, etc), though some (e.g., Prizma) have made a conscious decision to go ‘down market’ into such areas as modest shelter repair and reconstruction. While many of these new market niches might be justifiable, or not, on other developmental grounds (e.g., a shift into new SME lending seems positive given the complete lack of support for new starts from 1996 onwards), the fact remains that if MFIs move out of their original target market in order to survive, this means that they are no longer the same organisation that they set out to be. This is not an uncontroversial development. One might then enquire, if the microfinance model is so critical to poverty reduction and development, how is it possible to justify or tolerate an MFI gradually abandoning such an important mission later on simply in order to survive as a functioning commercial entity?
But perhaps the most important point here is not the financial sustainability aspect. After all, if microfinance is indeed producing measurable net positive impacts within the local community, then as Hulme and Mosely (1996) argue, subsidies can be easily justified or not on a cost-benefit basis. Instead, it is necessary to examine what evidence there is to conclude that the local enterprise sector and local economy must inevitably benefit from the continued and increased availability of microfinance. This is the crucial question. Moreover, if the microfinance model actually produces net negative benefits over the longer run, then, just as with bad medicine, the more microfinance disbursed, the more the local economy is actually being undermined.

McIntyre (2003) emphasises that there is little evidence to suggest that market automaticity and the associated free entry of large numbers of simple microenterprises as per the microfinance model, has anywhere produced a sustainable economic and social development trajectory. In general, the mass entry of ‘shallow’ microenterprises tends to correlate with a subsequently reduced likelihood of a sustainable growth and development trajectory taking root. The rapid proliferation of ‘shallow’ microenterprises and SMEs creates a set of adverse ‘initial conditions’ that, through a number of different mechanisms and feedback loops, tends to permanently hold back, if not entirely block, any further deepening of the local economic development trajectory. Some of the most important factors arising are: innovation processes are very weak, longer run investment is reduced because it is absorbed elsewhere in ‘quick return’ projects, human capital is also diverted into ‘quick return’ areas (‘learning to trade rather than learning to produce’), and technology diffusion and transfer fails to emerge because there is no constituency of support for it.

For example, the history of the African continent is replete with country and regional examples where massive expansion of the informal microenterprise sector has established a set of ‘initial conditions’ that ensure little can thenceforth be done to improve the economic situation. Typically, the informal sector was able to reach a ‘critical mass’ and thenceforth was able to divert most entrepreneurial skills, capital and commitment in its direction and away from other, more sustainable investments. The local financial sector gradually accommodated to the emerging situation, providing only short term loans suitable for the large proportion of trade-based ventures. The local education and training structure contracted to reflect the gradually
reducing requirement for sophisticated managerial, technical and production-based skills. The very entrepreneurial people in Sub-Saharan Africa have possibly ended up ‘locked in’ to an informal sector development trajectory ultimately going nowhere (for example, see Omari, 1999).

The increasing informalisation of Latin America in the aftermath of the failed neoliberal policy models of the 1980s has also been quite unable to produce a solid foundation for sustainable development. The massive microfinance support for, and thenceforth proliferation of, very simple microenterprises is seen as a reflection of the economic crisis, but not the way out of it. The early ideas raised by Hernando De Soto (1989), that the informal sector would provide a ‘motor for development’ in Latin America, have largely proved to be a massive and deeply damaging miscalculation. Instead, the new ‘post-meltdown’ governments, especially at the local level, are now focusing on directly promoting more sustainable forms of enterprise, such as innovation-led private businesses, worker cooperatives, community businesses, and financial cooperatives. For example, Argentina’s ‘melt-down’ has resulted in many thousands of new worker cooperatives emerging out of failed private businesses.22

Alongside this revised activity, central and local governments are also taking important steps at the meso-economy level to create the conditions for sustainable development - directly promoting key institutional linkages such as local subcontracting chains, supporting SME networks and clusters, and designing public procurement-led microenterprise development and support initiatives. Overall, as UNCTAD (2003) has concluded, resolving problems of extreme poverty, under-development and marginalisation in Latin America, and elsewhere, urgently requires just such a range of proactive local industrial policies – in other words, policies which are the antithesis of the commercial microfinance model.23

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22 See the report by Jeter (2003).

23 The 2003 Annual Report of UNCTAD was at pains to highlight the fact that the IFIs’ continued reluctance to sanction local industrial policies is a major barrier to sustainable development in both developing and transition economies alike. This factor effectively leaves these countries with, “no chance of nurturing the home-grown firms which are crucial to economic success”. What the transition and developing countries urgently need, the lead author of the UNCTAD report maintained, is “. . . the policy space: the ability to nourish, support and develop domestic industries, and the capability to compete in international markets and to supply the home market”. See “Free-for-all on trade will harm everyone, says UN”, The Guardian newspaper, October 3, 2003.
Further challenging evidence also comes from the now more than thirty year old Grameen Bank experiment itself – the single most important catalyst behind the spectacular growth in popularity of the microfinance model and the microfinance ‘industry’. To date, the Grameen Bank has been signally unable to offer convincing proof that it has indeed helped to underpin a sustainable development trajectory in Bangladesh. Typically, its ‘success’ is portrayed in terms of its survival (thanks to scaling up, its commercial approach – also thanks to subsidies quietly obtained from the government and international community), its high repayment rate (a function of its pioneering group solidarity methods), its accessibility to the poorest (thanks to its extensive branch network), and its work with poor women (thanks to its targeting approach). But these are operating modalities, not impacts. In fact, there are few, if any, studies that have shown exactly how it has impacted positively over the longer term on growth and development. As one analyst pointedly remarked (Saith, 1990:287),

“It (Grameen Bank) has succeeded to a great extent. The only problem is the criteria against which it is evaluated. A lot of people have tried to declare it to be a successful model based on certain criteria that it does not achieve, such as national economic impact. (...) The Bank does not care how the poor use the money as long as it is repaid. Thus, most of the money goes into trade. So, instead of buying cigarettes from a shop, you can buy cigarettes from a little fellow sitting out on the street. This is good for the little fellow but does not increase GDP much. We would need a very complex model of how trade builds up, its investments and its reallocation to have any long-term impact on the development process”

Those evaluating the Grameen Bank experiment have also tended to shy away from making any comparison with other local interventions targeted at the same client profile, such as, say, a generalised version of the local public works and cooperative development programmes undertaken in Kerala State in neighbouring India. The Kerala model is a verifiably successful intervention on key economic and social
development fronts over more than 40 years, and established in very similar circumstances as in Bangladesh too.\textsuperscript{24}

In the transition economies of Eastern Europe, there is also a dearth of evidence linking the microfinance model to sustainable development. In Poland, Hardy and Rainnie (1996) found that the rapid expansion of the microenterprise sector did not construct an appropriate platform for sustainable development: quite the reverse, in fact, a conclusion now backed up by events subsequent to their initial research work (see below). In Slovakia, like BiH a formerly heavily industrialised economy with a significant military-industrial complex, Smith’s (1998) evidence points to the fact that the significant microenterprise growth since 1990 has been quite unable to establish the necessary foundation for sustainable development. International community predictions that a local industrial complex would spontaneously emerge thanks to new SME entry were all dashed, largely because the emerging SME sector mainly involved the familiar set of trading, small-scale services and speculative (especially real estate) ventures. Overall, Scase (2003:76-7) is forced to conclude with regard to Eastern Europe that,

\textit{“While the small-business sectors of the economies of Russia and Central Europe do fulfil important material and ideological functions, they seem to possess little in the form of system-transforming capacities. Because they overwhelmingly consist of proprietors rather than entrepreneurs, they are unlikely to generate either economic growth or rational, capitalist forms of economic production. (..) the role of small-business sectors is certainly very real but, alongside other processes of capital restructuring and institutional transformation, relatively unimportant\textquotedblright}

A good illustration of such possibly adverse ‘initial conditions’ emerging more recently and close to home (i.e, to BiH) is to be found in Kosovo. In 2002 (September 14\textsuperscript{th}) the London-based Economist magazine lauded the ProCredit Microfinance Bank (formerly MEB Bank) for its strong financial performance and that it was the most profitable bank in all of Eastern Europe. The impression given was that Pro-Credit

\textsuperscript{24} See Parayil (2000).
was leading the way in assisting the dangerously weak Kosovo economy into generating a new sustainable development trajectory. However, this is not the case. ProCredit’s business loan portfolio in mid-2002 involved loans to microenterprises and SMEs engaged in the following sectors: 66% trade, 20% services, 12% production and 2% agriculture. The ‘trade’ component was mainly small retail shops (kiosks) and cross-border trade (legal and illegal). The ‘services’ component was mainly small repair facilities, recycling and cleaning, while ‘production’ mainly involved small operations adding value very quickly, such as simple food preparation. Meanwhile, the economy of Kosovo effectively continues running into the sand, among other things reflected in now unsustainable import dependency (nearly 90% of food items are imported), the closure of most no-longer-needed technical support institutions (i.e., education, technical training, advice), the very high level of informality and illegality in the enterprise sector, and the continuing inability of potentially sustainable formal sector SMEs to access capital on affordable terms and maturities. In other words, ProCredit is managing to prosper as a very tiny island of spectacular commercial success within a vast ocean of unsustainable, mainly trade-related enterprises. Pro-Credit has, in fact, been quite instrumental in creating a now dominant mercantilist ‘bazaar economy’ and not much more than this. Such a development trajectory, it is now belatedly being recognised,25 is an extremely unlikely foundation upon which to secure the long-term future of the one of the world’s poorest and most vulnerable regions.

3.2. Assumption 2: The rapid expansion of the microenterprise sector in Poland ‘worked’ very well in Poland, so it should also ‘work’ in BiH.

The very rapid expansion of the microenterprise sector in Poland after 1990, thenceforth supported after 1994 by a wave of new Polish MFIs established with international community funding, has been widely cited to be one of the key foundations helping in its transition to the market economy (Johnson and Loveman, 1995). With more than fifteen years of microenterprise experience to consider, can it therefore be confirmed that the ‘microenterprise boom’ in Poland made an identifiable contribution to achieving sustainable development?

The collapse of communism in Eastern Europe led to a series of IFI-designed neoliberal ‘shock therapy’ programmes, including the 1990 ‘Balcerowicz Plan’ in Poland. The ‘Balcerowicz Plan’ was mainly macro-economic in scope, but partly predicated upon the sustainable ‘bottom up’ rebirth of the local economy through massively expanded individual entrepreneurship, which would arise automatically as a result of the rapid deregulation, privatisation and liberalisation processes underway.\textsuperscript{26} Financial support was a little later forthcoming from a range of new international community financed MFIs, including a number of US government small enterprise funds and, from 1994 onwards, from \textit{Fundusz Mikro}, now one of the largest and most high profile MFIs in Poland and in Eastern Europe. The end result was that more than two million new microenterprises were registered in Poland in just a few years after the transition began, with a more gradual rate of microenterprise entry in the subsequent years. In an almost perfect neoclassical economic development trajectory, Poland quickly became ‘alive’ with millions of new micro-entrepreneurs engaging in whatever business they could easily enter and make money out of. Stories abounded of what some of the most enterprising individuals were doing, and how particular cities and localities were changing beyond all recognition thanks to the massive inrush of new entrepreneurs and new microenterprises, particularly new retail outlets selling the best branded products the western economies had to offer. Overall, these ‘hothouse conditions’ were deemed by the Polish government at the time, and by many foreign analysts as well, to have been the decisive factor in the rapid, and supposedly sustainable, initial transition progress of the Polish economy based on private sector development.

By the late 1990s, however, it became clear that things were not quite what they initially seemed to be. The ‘entrepreneurship revolution’ had actually generated a number of quite debilitating longer run negative externality impacts which, combined, seemed to be swamping any positive immediate poverty reduction effects associated with large numbers of new microenterprises.

\textsuperscript{26} Balcerowicz was personally very strongly ideologically opposed to special programmes of support for SMEs, maintaining that stabilisation, privatisation and liberalisation were all that was required to establish a sustainable SME development trajectory (see Balcerowicz, 1995, p 246). One further aspect of the prevailing neoliberal fundamentalism was the World Bank’s refusal to accept the Polish government’s plans for a Development Bank geared to the careful restructuring of the best remaining Polish enterprises, including SMEs (see Amsden \textit{et al}, 1994).
First, it was indeed the case that the numbers of microenterprises and SMEs increased very rapidly after 1990. For example, from the end of 1989 to mid-1992, the number of new small businesses in Poland increased by 710,000 (Sachs, 1993:63). The rate of entry slowed down from 1994 onwards, but it was still quite considerable. The overwhelming majority of these new registered entities, however, were microenterprises engaged in very simple trade-based activity (cross-border activity, street selling, kiosks, etc), petty services and speculation. This trend continued well into the mid-1990s, supported even more by a number of new high profile MFIs established with international community support. The Grameen Bank experiment was the immediate inspiration behind the establishment of one of Poland’s largest MFIs - Fundusz Mikro - which then went on to develop a ‘shallow’ trade and service-based client portfolio very closely resembling that of the Grameen Bank operating in Bangladesh.27 There was considerable exit too, but mainly involving long established SMEs. For example, in 1992 alone more than 150,000 SMEs were liquidated, a very good many of which were long established production-based and industrial services SMEs, to be ‘replaced’ in the same year by more than 500,000 mainly microenterprises overwhelmingly involved in trade, retail and simple services (Hardy and Rainnie, 1996). By 2002, every second SME active in Poland was engaged in the retail trade (Surdej, 2003).

Crucially, the new independent, private financial institutions – new small private banks, venture funds, and the earliest MFIs established with international support – were quite decisive in helping to establish this ‘shallow’ enterprise structure. Naturally keen to ‘get a slice of the action’ through high interest rates, wide margins, one-off management fees, and various other charges, the new financial institutions were quick off the mark in using the new freedoms and opportunities to very deliberately channel their funds into the most profitable short term business opportunities, particularly into new trading ventures able to recycle cash very quickly. For most SMEs, particularly those involved in production, incorporating some new

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27 Of the more than 54,000 loans disbursed by Fundusz Mikro between 1994 and March 1st 2003, amounting to over $100mn in total, 56% of the loans went to traders, 35% to small-scale services and 9% to production (data accessed at www.funduszmiro.pl).
innovation, in need of newer technologies and equipment, or involved in exporting, almost no funding was made available for them – that is, they were ‘crowded out’.  

While initially the structure of the microenterprise sector was not seen as a problem – indeed, it was a natural market-driven development celebrated by Jeffrey Sachs, one of the main advisors to the Polish government (see Sachs, 1993) - the longer term consequences of the initial ‘crowding out’ phenomenon are now increasingly recognised as adverse. One outcome was that virtually the only production-based microenterprises and SMEs that managed to start and/or remain in business during this heady period (in fact, they initially proliferated) were very low local value added ‘loan system’ type business operations, especially in textiles, taking advantage of temporary market advantages. In addition, Poland’s lead in many promising small-scale technologies, highly skilled population and its immediate past history of exciting domestic innovation activity were both largely abandoned as the source of new sustainable enterprises.  

A second problematic issue relates to the fact that, as just noted, the expansion of the microenterprise sector was very much concentrated in small-scale trading activities. And this new group of microenterprises was quite decisive in facilitating the massive and instant splurge of consumption goods imports which took place in the first few years of the transition. Often operating alongside family, friends and business associates working in Western Europe, many Polish traders were put in touch with Western European companies only too eager to provide generous supplier credit and

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28 This phenomenon caused some real confusion within the IFIs across the entire transition economies, not just in Poland. Urgent efforts were made to arrange training for the staff in the new financial institutions in the mistaken belief that the lack of more sophisticated clients had something to do with the new financial institutions’ inexperience in assessing credit risk, efficiently screen business plans, and so on. In actual fact, most new financial institutions knew exactly how to identify the type of clients they wanted – those making the most money - and they were by and large successful in finding them and working with them in such a way as to obtain as big a cut of the rewards as possible (see Bateman et al., 2002).

29 Haudeville et al (2002) remark upon the high level of technologies, skills and innovation activity in Poland prior to 1990 and note that, unlike some other transition economies, almost none of this valuable inheritance was utilized or built upon in Poland after 1990.
‘sale or return’ offers in order to get non-Polish goods quickly into Poland.\(^{30}\) The most obvious immediate negative effect of this development was on the overall trade balance, which quickly ballooned after the onset of the transition and for a considerable time absorbed a good part of the country’s financial resources. However, the ‘import boom’ also significantly contributed, along with the commercial imperatives issue noted above, to wiping out a very large number of well established and potentially reasonably efficient Polish SMEs, just as they were beginning the process of carefully restructuring, retooling, reinvesting and retraining in order to compete in the new liberalized and marketised environment.

Moreover, Poland was and is a major agricultural economy, and much was expected of the Polish agricultural sector in 1990 in terms of being able to rapidly facilitate increased exports of agricultural items to the EU and elsewhere. However, by quickly flooding the Polish market with cheap (surplus) EU agricultural items incorporating EU subsidies, the swelling population of shuttle traders had a major negative longer term impact here as well. They were, in fact, quite decisive in helping to turn a $557 mn surplus on agricultural products with the EU in 1989 into a $333 mn deficit by 1993. Local farm incomes fell by 50% as a result and by 1995 60% of Polish farms were technically bankrupt.\(^{31}\) By the late 1990s, according to Kowalski and Kaminski (1999), rural working and living conditions in Poland had deteriorated to levels not seen since the mid-19th century. The rural areas have still fully recovered from the devastating immediate impact of the instant flood of imported food items registered after 1989, and high levels of poverty, rural unemployment, uncultivated land and social marginalisation remain serious problems facing the Polish government. Alone among 2004’s wave of new EU members, rural poverty has actually been on the increase in Poland over the last five years.

Third, the massive rise of the informal sector inevitably ended up socially legitimising and thus greatly underpinning many emerging illegal business practises. The widespread avoidance of tax, the use of illegal ‘hiring and firing’ practises, the permitting of dangerously unsafe working conditions, and so on, became routine business strategies the average entrepreneur simply had to deploy in order to compete

\(^{30}\) For example, see Feakins (2002).
with the burgeoning informal sector. In the country that gave rise to the trade union *Solidarity*, many private companies feel they have no other option but bar their employees from establishing trade unions. Even former Solidarity officials now owning and working in their own small business resist a trade union in their establishment, fearing that it will prohibit them from competing just as aggressively as their competitors in terms of low wages, poor working conditions, no social benefits and limited job security. Very much as elsewhere, the massive expansion of the informal microenterprise sector in Poland was a major contributory factor in the destruction of important local accumulations of social capital and social solidarity.

In sum, based on what we now know, a reasonably balanced assessment of the microenterprise ‘revolution’ in Poland would be that it probably destroyed into the longer term probably more than it created in the short term. The bulk of microenterprises and SMEs active today are mainly cushions against unemployment, rather than the nascent building blocks of a dynamic local economy. The eventual limitations of the Polish microenterprise ‘revolution’ were correctly recognised by Hardy and Rainnie (1996:252) pretty early on, concluding that:

“...the emergence of a flea market, rather than the myth of the free market, is no basis on which to build successful local economic development”

3.3. Assumption 3: The new ‘impact evaluation’ methodologies ‘prove’ that microfinance has been a net positive benefit in BiH.

A new evaluation methodology emerged as standard practise within the IFIs in the 1980s and early 1990s, that of ‘impact evaluation’. ‘Impact evaluation’ basically looks at the results of an intervention in one community compared to a similar community that did not receive the intervention. No matter how much was actually spent on any intervention, so long as it made a positive difference compared to the community where no such intervention took place, then it can be justified as being beneficial. A major ‘impact evaluation’ was undertaken of the World Bank’s LIP project in BiH, completed in 2005. Essentially, the study found that across a range of issues - household welfare, business development, etc - the LIP improved the position of those clients in receipt of microfinance compared to those in counterpart
communities not in receipt of microfinance (see Dunn, 2005). Therefore, it was good ‘value for money’ and fully justified the level of support given to it by the international community.

The ‘impact evaluation’ methodology is deeply flawed, however. As Ellerman (2005) has shown, while statistically valid and useful in some very narrow experimental economics areas, such a comparison is largely invalid in the economic policy area. To genuinely assess the ‘worthwhileness’ of any intervention requires, among other things, serious consideration of the ‘counterfactual’ or opportunity cost – the next best use of the same amount of resources. This would mean other programmes targeted at the same client group. Possible counterfactuals for the microfinance model would include a local public works employment programme or an SME development programme, both of which are also designed to reduce poverty, promote local employment and increase longer term income generation possibilities. In ‘impact evaluation’, however, the counterfactual is usually defined to mean the situation where no resources are committed. Of course, it is not easy to find genuine counterfactuals against which to assess the impact of any intervention. But the need to find the best possible interventions in difficult situations should actually encourage the search for alternative policy interventions against which to measure (i.e., on a cost-benefit basis) the one which might, for whatever reason, be initially favoured.

The LIP ‘impact evaluation’ also makes no comment as to whether or not the structure of microenterprises the LIP helped into existence - largely simple trade and services ventures, overwhelmingly in the informal sector – is actually sustainable into the longer term. So long as clients repay their microloans, the MFIs and their IFI sponsors do not think that it is their concern to go any deeper than this. But it is not as simple as this. First, with such high failure rates, most of what is ‘created’ is actually quickly destroyed. Also, because many family-based entrepreneurs in BiH wish to avoid local embarrassment and shame, very high failure rates mean that scarce personal financial resources are often diverted to repay a microloan taken out on a now non-functioning business venture. Second, there is no discussion as to whether or not the emerging enterprise structure will in BiH ever stimulate the recognised local externalities that underpin sustainable development – that is, insertion into local and regional value chains, potential to cluster and network, technological upgrading,
export orientation, and soon. Nor did the LIP evaluation examine whether other local programmes might have impacted better and/or more sustainably upon the target client group (e.g., community-driven employment programmes). This is not an easy nor inexpensive undertaking, but it is both possible and desirable if the motivation to find the best possible local intervention is present. Along these lines, for example, Ellerman (2005) has proposed a combination of ‘scanning globally’ and ‘reinventing locally’ in order to arrive at sustainable local economic and social development policies that are best in keeping with local circumstances and potentials.

4. Key problematic issues with the microfinance model in BiH

The above section briefly examined three of the main assumptions used to justify the microfinance model in BiH. The conclusion reached was that these assumptions are pretty much without any serious foundation. In this section, I elaborate further on a number of the most troubling areas where BiH’s actual microfinance experience to date may have had a role to play.

3.1. Deindustrialisation and infantilisation of the BiH economy

A good many economists predicted at the beginning of the transition process in Eastern Europe that neoliberal transition policy would inevitably, and quite unnecessarily, destroy a very large part of the industrial sector and technological base. This view was particularly strong in the case of those economists with experience of the highly destructive neoliberal restructuring episodes (i.e., Structural Adjustment Programmes, SAPs) in Latin America and the highly positive ‘developmental state’ experience registered in many countries in East Asia (for example, see Amsden et al, 1994: Taylor, 1994). If developing countries were desperately and rightly trying to absorb new technologies, generate and utilise their own innovations, and move into higher value added manufacturing activities incorporated into international value chains, it did not make much sense for the newly democratic Eastern European governments to simply abandon whatever industrial, technological and human capital assets they had to date been able to accumulate and effectively ‘return to square one’. A clear industrial policy perspective was therefore required, including a prominent
role for the state in terms of being able to mediate change, help the economy adapt to the external shocks and promote new sustainable trajectories of industrial change.32

This developmental imperative also included an urgent need for a specifically local industrial policy approach. Crucially, this local industrial policy would involve the establishment of a stock of pro-active local development institutions that could support new ventures and marshal the best of the existing stock of microenterprises and SMEs towards higher levels of productivity, innovation and technology intensity, encourage vertical and horizontal interaction and information exchange, and provide direct encouragement for new microenterprises and SMEs to ‘organically’ emerge from the very many declining large industrial enterprises. As Brunner (1996:214) correctly warned,

“Successful East Asian economies have shown that industrial and regional policy programmes are a necessary part of a strategy that does not rely on a belief in a spontaneous rise of the entrepreneurial phoenix. From past experience it is clear that functioning markets and capable market agents have to be created and sponsored by conscious institutional design and public policies”

One of the most immediate worries raised by developing country experience related to trade liberalisation (see also below). Especially in the absence of countervailing industrial and trade policies, there was a very real possibility that virtually all production-based SMEs might be immediately washed away by a flood of imports, and not just the least efficient and thus less likely to ultimately succeed. This, for example, was one of the key, if unpalatable,33 findings of a major four-year study undertaken by the Washington DC-based SAPRIN in collaboration with the World Bank looking at the longer term effects of neo-liberal policy in developing countries (SAPRIN, 2001:26) which concluded that,

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32 For an excellent description of what such industrial policies and associated ‘transformative capacities’ mean in practice, see Weiss (1998).
33 When it became clear to the World Bank that most of the individuals, government officials and NGOs consulted in the SAPRIN exercise ended up criticising the Bank’s own neo-liberal policies, the Bank belatedly dis-associated itself from the SAPRIN programme and pointedly refused to publicise and disseminate the research results any further (see SAPRIN, 2001, p 3).
“Trade liberalisation should not be implemented before an industrial policy is in place to address the structural constraints causing the inefficient operation of local enterprises”.

However, in post-communist Eastern Europe proposals for national and local industrial policies gained no traction whatsoever within the IFIs. Instead, as per the standard neoliberal policy model, market forces were allowed a free hand to reconstruct and shape the economic and industrial structure, including the SME sector. The well known result of this market freedom was the so-called ‘transition depression’. The ‘transition depression’ was characterised by a massive collapse in demand alongside the very rapid ‘hollowing out’ of the industrial and technological infrastructure, generalised import dependency, and the growing importance of the informal sector as a source of jobs and income for the majority of the population.34

In BiH the international community’s resistance to industrial policies was as robust as in the wider Eastern Europe, and the results equally disappointing. A deindustrialisation trend was initiated in BiH that has, over the subsequent decade, resulted in the dismantling of most of the industrial fabric – industrial enterprises, industrial skills-sets, industrial R&D and technical support institutions, industrial innovation-led programmes and so on. The overall situation in BiH today now very much resembles the enterprise structure typical of Latin America and Sub-Saharan Africa: that is, a small number of large (private, multinational and state-owned) enterprises operating alongside a large population of microenterprises, but with virtually nothing in between – that is, there is a ‘missing middle’. As everywhere else, the IFIs stood by their earlier predictions that the privatisation of the BiH economy alone would stimulate industrial recovery based upon a spontaneously revived relatively technology-intensive modern enterprise sector. But this prediction did not come to pass, among other things because, as a UNESCO mission team to BiH was forced to report (UNESCO, 2005: 5),

“…the privatisation of the economy (.) does not take into account the necessity of preserving the technical capital of industrial companies

34 But a result which was seemingly totally unexpected by the IFIs and their high profile economic advisors.
which, in some sectors (energy and metallurgy for example) remains valuable’.

Crucially, in a number of ways it is possible to detect that the microfinance model introduced into BiH after 1995 has been an important contributory factor to the current adverse situation. The core imperative of the MFI in BiH, as increasingly everywhere else, has been to ensure its own survival through being able to ‘earn its keep on the market’. This narrow internal aim has been pursued through overwhelmingly providing micro-loans only at market-based interest rates (averaging 2% to 3% monthly interest rates) over short repayment periods (generally 6 to 18 months). How did, and do, potential entrepreneurs in BiH react to this new microfinance-dominated local financial environment? Some new entrepreneurs were happy to tap into micro-credits made available to them and establish a small venture involving a very simple informal sector activity, such as shuttle trade, kiosks and small-scale retail outlets, petty services and some simple production-based activity that added value very quickly, these being the only business sectors capable of repaying a high interest loan over a very short period of time.

However, in 1996 a large pool of quite sophisticated entrepreneurial talent and vision existed in BiH at the time, mainly arising out of the long industrial traditions in the region and the many world-class enterprises engaged in engineering, construction and the military-industrial complex. It was therefore not a surprise when very many new business ideas began to come forward after 1996 in BiH which incorporated technologies, innovations, complex products and processes and utilised highly skilled labour. As Ellerman (2005) has argued, this inheritance constitutes a hugely valuable resource of entrepreneurial, industrial and technological ‘genetic material’ that could and should, catalysed by outside stimulation and assistance, be recombined into rafts of new smaller enterprises. Moreover, because it is inter-enterprise learning that accounts for the bulk of technology transfer affected everywhere, particularly of the larger enterprise to smaller enterprise variety (for example, see Bhalla, 1992), crucial and widely predicted technology transfer processes would only take place in BiH if there was a background of vibrant, industrial-based, relatively technology-intensive microenterprises and SMEs.
However, almost all of these potential entrepreneurs found that the microfinance model was wholly unsuited to their needs. Business plan projections indicating break even or profitability in a couple of years, or long term low profitability, or where substantive investments had to be made, or where some complex ‘learning by doing’ economies had to be reaped, all made no sense whatsoever within the microfinance paradigm. In the absence of any substantive alternative to the microfinance model, as intended by the IFIs, the bulk of these potential entrepreneurs were forced to abandon their ideas. Some frustrated entrepreneurs shifted into doing something very much simpler and which would be serviceable within the microfinance model, often simply plunging into a trade or service-based venture along with the rest. Some found work in the formal sector or international donor community. A few former refugees and gastarbeiter previously living in Germany and Switzerland even took up an offer of financial and technical support from the German and Swiss governments if they would return in order to establish any sort of technology-intensive and/or innovative small venture. The loss (opportunity cost) to the BiH economy as a result of this ‘adverse selection’ phenomenon is difficult to estimate, but it is clear that it must be very significant indeed.

A good example illustrates the possible extent of ‘adverse selection’ losses in BiH brought about by the microfinance model. Probably BiH’s most famous company is the Energoinvest company network, once one of the most technically advanced and innovative companies in Eastern Europe. Recognising that a highly skilled workforce and industrial R&D were the keys to its success, among a number of interventions

35 The microfinance model tends to ignore the losses or opportunity costs represented by the very many individuals who are forced to turn away from and abandon a good business idea when confronted with the onerous financial terms and conditions offered. But it is important to look at exactly who are the individuals who ‘turn away’ because it is very often their business ideas that prove to be the best into the longer term, even if in the short term they will have problems obtaining appropriate financial support. The nature of this ‘adverse selection’ problem has always been appreciated in development economics. For example, Scitovsky, one of the pioneers of growth theory, argued that we should not rely on the current market price of capital to direct investment decisions since it will “…reflect the economic situation as it is and not as it will be. (instead) investment decisions should be governed…by what the future economic situation is expected to be.” (Scitovsky, 1963, p 305-6. Quoted in Pack and Westphal, 1986).

36 During the 1992-95 conflict in BiH an ‘adverse selection’ process was also very much in play helping to produce an ultimately adverse result. The very particular war-time financial system - i.e., extremely high interest rates (10% per month) and repayment periods not more than three months – both gave rise to and accommodated to, a very particular structure of microenterprises consisting of inter-locking networks of smuggling and illegal trading and distribution enterprises (Bateman, 1994). These groups constituted the basis for much of the post-conflict illegal and ‘mafia-ised’ business enterprises, attitudes and practises.
over the years, *Energoinvest* had established its own Electro-Technical University to train its own people in technical and business development issues and produce new innovations and develop new and adapt existing technologies from abroad. In common with virtually all industrial enterprises in BiH in 1996, however, *Energoinvest* was forced to seek ways to drastically reduce its workforce. One way was to encourage existing employees to launch their own new small enterprise, and thus depart into a reasonable future. The company offered some support for this endeavour, including technical advice, finance and even some small contracts if appropriate. It greatly helped that *Energoinvest* ’s employees were somewhat different to other employees in BiH. This was because the company had provided a working environment based upon the generation of new industrial products and processes, developing new skills, exploring new technical innovations, raising the level of understanding of new technologies to the wider European level, and the making of a wide range of international business contacts. Thus, *Energoinvest* provided an almost ideal practical ‘breeding ground’ for the spawning of new small entrepreneurial ventures based upon reasonably sophisticated and innovative product and process ideas, rather just simple arbitrage.\(^{37}\) However, the overwhelming majority of those who thought seriously about responding to the call to set up their own such business quickly found that realistically they could not access funds from the network of international donor community financed MFIs.\(^ {38}\) The result was that virtually all of the potential new small business ideas arising from employees within *Energoinvest* were aborted or else substantially ‘downgraded’ into something much easier to finance.

We should also just mention at this juncture the familiar counter-argument often raised in response to the above deindustrialisation argument. Part of the above analysis is sometimes accepted by proponents of the microfinance model. However, a wider fallback argument is introduced which posits that MFIs in BiH will eventually shift their attention towards dealing with more sustainable growth-oriented industry-

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\(^{37}\) For example, see Ellerman and Kreačić (2002) for details of the ARIA Project. This was an innovative World Bank project in Moldova that successfully gave birth to a raft of new small and dynamic enterprises within the collapsing hulk of an old state owned industrial enterprise.

\(^{38}\) Bosnia’s new private commercial banks were and remain extremely risk averse, for example ‘investing’ most of the capital they raise locally in German and UK bank accounts (see Caušević, 2002). And other donor funds supporting enterprise development were overwhelmingly aimed at existing SMEs with good export potential or a good track record of operation prior to the conflict.
based microenterprise and SMEs in future once they (the MFIs) finally ‘mature’ – that is, gain in financial strength and technical capacity. Does this counter-argument have any weight? Probably very little. First, in the time it takes for MFIs to begin to reach out to more sustainable growth-oriented businesses, if indeed they ever do, irreparable damage to the industrial fabric of the economy is likely to have already been done: a classic case of ‘the cure eventually being found, but in the meantime the patient has died’. Second, as a quick history of the institutional economic development of the African economies amply demonstrates, once a structure of petty services and industry has been firmly established within the local economy, a set of ‘initial conditions’ has been created that militates strongly against any further changes (i.e., ‘path dependency’ sets in) no matter what the international community, government, or anyone else tries to do about it. For example, highly profitable small importing concerns almost inevitably begin to build up a constituency of local political and other forms of support that effectively precludes or monopolises the local finance, skills and political support needed for possible local import substitution alternatives to emerge.

For the same reasons we can also largely discount the related ‘primitive accumulation’ argument derived from the fact that some small-scale traders and importers in BiH will of their own volition eventually move to invest their accumulated capital into more substantive business areas.

3.2. The creation of an atomised ‘unconnectable’ local enterprise sector

It is increasingly accepted that the connectedness of the local enterprise sector is one of the crucial determinants of a local economy’s future sustainability, and not simply, if at all, the numbers of enterprises therein. With a variety of enterprises engaged in more demanding areas with regard to technology, innovation, skills, coordination and planning, managerial competences and so on, it is possible, though not inevitable, for a local economy to advance and prosper in a sustainable manner. This insight is pretty conclusively underpinned by a number of academic and research traditions encompassing the new economic geography, Industrial Districts, social capital theory,

39 For example, see Kinunda-Rutashooybya and Olomi (1999)
40 Many of the most important insights on these forms of ‘path dependency’ have come from the institutional economies work of Douglass North (see North, 1981).
cluster and network theory, value chain analysis, the role of technology and innovation, and so on (for example, see Pyke and Sengenberger, 1992; van Dijk and Rabellotti, 1997; OECD, 1999; Schmitz, 2004).

In some EU countries, notably in Germany, France, Italy and the Scandinavian countries, the microenterprise and SME sectors have flourished by linking up horizontally with other SMEs, and vertically into the demand arising from larger firms. In some regions, rafts of inter-linked cooperative enterprises have become the core feature of a successful sustainable regional development experiment, most notably in the Basque region of northern Spain and in the region of Emilia-Romagna in northern Italy. Taiwan’s status as a ‘Tiger’ economy largely rests on its dynamic and intensively networking industrial SME sector. Although at the time one of the world’s poorest countries, Lall (1996) points out how Taiwan was nevertheless able to coordinate the use its own and donor resources to offer significant technical and financial support to upgrade these networks and clusters.

China’s remarkable rise from one of the world’s five poorest nations in 1980 to economic power-house today, was initiated by establishment of millions of local government and community owned small enterprises – Township and Village Enterprises (TVEs). The largely production-based TVEs were initially able to provide simple manufactured products for local markets but, thanks to intensive reinvestment and technical support from a wide range of local institutions, the TVEs managed to then break into international value chains. Also crucial to the development of the TVE sector was the simultaneous establishment of networks of rural and urban credit cooperatives, offering low cost and long term finance to production-based TVEs with a solid chance of success in the market (Girardin and Ping, 1997).

In BiH, however, generally no strong positive spill-over effects arising from connectedness are possible precisely because the agglomerations of microenterprises and SMEs arising from the microfinance model to date are overwhelmingly unsuitable to the task. The microfinance model in BiH has succeeded in using scarce international community funding, and gradually also the savings of local people, in order to produce significant numbers of new microenterprises. However, the overwhelming majority of these individual microenterprises are completely unsuited
to forging the efficiency-enhancing horizontal and vertical connections seen everywhere else as crucial in establishing and embedding a sustainable growth and development trajectory in place. Nor do the high rates of microenterprise entry and exit that prevail in BiH manage to reap important Schumpeterian ‘creative destruction’ effects, not least because so few microenterprises incorporate innovation, technologies and important skills and knowledge that could be usefully recombined and transferred much more widely to other microenterprises upon exit.

In sum, there is simply no evidence to believe that the current attachment to market automaticity, undergirded by the microfinance model, has been able to generate a sustainable agglomeration of enterprises marked out by a potential for intensive efficiency-enhancing vertical and horizontal interaction. Most experience shows, instead, that sustainable development has not been encouraged or automatically induced by such a ‘shallow’ structure of microenterprises and SMEs, but actually choked off, possibly permanently.

3.3. Planned failure to reach minimum efficient scale of operations

The microfinance model not just promotes small enterprises, but also largely generally promotes small enterprises below the minimum efficient scale that pertains to the particular enterprise sector in which they operate. This under-capitalisation strongly suggests that there will be problems of enterprise growth and sustainability at some future date. Notwithstanding (once more) the many short term poverty reduction benefits arising from the microenterprise model, it is also the case that the sub-optimal size structure is precipitates is akin to a ‘house of cards’ – an enterprise structure that looks pretty good for a while (that is, can be evaluated positively during the life of the project), but it then pretty much collapses later on thanks to natural and to-be-expected market development processes.

There is strong evidence for such negative outcomes across the region, including in neighbouring Croatia for example. In Croatia a number of MFIs were established after 1996 and, as everywhere across the world, chose to begin (capitalise) their operations by supporting the small-scale trading sector. Good initial profits and quick turnover in trading activities was pretty much the norm right after 1997-8, and so these clients
were relatively easily and quickly able repay any microloan. But the trading sector began to run into difficulties around 1999 and 2000, largely because of increasing horizontal competition from other small traders, and vertical competition from newly established large trading and retail ventures and supermarkets. The MFIs saw the all-important repayment rate begin to decline. The MFIs concerned quickly decided to ‘cut their losses’ and to shift into a completely new field - subsistence agriculture - in order to find more reliable clients. The typical client then became a small farmer wanting an additional cow or two in order to qualify for government subsidies (which in Croatia were based on there being a minimum of three cows per family farm).

Quite predictably, within a year or two very similar problems of a lack of scale began to arise. Local dairies were inundated with very small farmers wishing to sell a few tens of litres of milk, and so prices dropped. Worse, newly privatised dairies began restructuring their local supply chains by weeding out the smallest and most inefficient suppliers, which, of course, mainly meant those farmers supported by the MFIs. So this second client group also became problematic. As before, some MFIs did not wait around to perhaps deal with the emerging dislocation and market chaos, but instead began a move into SME loans, housing loans, and other conventional financial instruments. At least one of the MFIs took the final obvious step and began to convert into a small commercial bank offering highly collateralised loans to SMEs (see IMC Consulting, 2004). In short, the driving force to become financially sustainable means that very little, if any, concern is registered for the sustainability of the local structure of microenterprises being created. Put crudely, the key lesson from Croatia seems to be that so long as clients can repay their microloans before going under, then there is nothing to worry about.

And indeed, the very same dynamics began to emerge in BiH too. The first rush of microfinance-supported arbitrage activities in BiH was partially brought to halt around 1999-2000 when many small informal trading and importing businesses began to run into difficulty. As market saturation and market development took place (i.e., new supermarkets), the limited ability of such small units to reap economies of scale and scope meant that margins began to decline, the ability to reinvest and scale-up declined, and the rate of exit began to rise. Some MFIs in BiH could see the writing on the wall and thenceforth began to bar their microloans from being used for simple trading activities, preferring to change focus on to other more sustainable market
segments. But other MFIs in BiH, just as in Croatia, began to shift into supporting subsistence agriculture instead. And here too once the local market developed, and particularly as local agricultural processors in BiH were privatized and profit considerations forced them to reduce their traditional small rural supplier base, the new wave of small and mostly inefficient microfinance-induced farmers became the first to be winnowed out of the local supply chain. Of course, in BiH many small-scale MFI-assisted farmers have survived, and a tiny few have even prospered (some becoming role models for the MFIs that initially supported them). But it is widely recognised in BiH that the emerging structure of very tiny farming units is not the most appropriate foundation for future sustainable growth and development in the agricultural sector.

3.4. Facilitating trade deficits and import dependency

One of the most damaging features of the neoliberal programmes that developing countries were forced to endure during the 1970s and 1980s was the collapse in local manufacturing and agricultural production brought about by instant trade liberalisation and an ensuing flood of (often subsidised) imports. Thanks to the basic operations of ‘quick and easy to enter’ small importing ventures, import dependence was quickly embedded into the system. The debilitating longer run impact of import dependency meant that it ultimately destroyed any short term poverty reduction gains made during the initial phase of trading sector micro-enterprise expansion. SAPRIN’s (2001: 5) conclusion was that the initial uncontrolled surge of imports needlessly contributes to,

“The failure of many local manufacturing firms, particularly innovative small and medium sized ones that generate a great deal of employment. The decline in domestic manufacturing has followed the flooding of local markets with cheap imports that have displaced local production and goods and has been exacerbated by the absence of an industrial policy to support domestic firms in dealing with new conditions or with shocks in international markets”..
Given that simple trading ventures are cheap and easy to enter and require little in the way of special skills, they are very understandably the first destination of many individuals seeking a route out of poverty. And if MFIs are willing to deal with such business propositions, because the initial profitability is enough more than enough to deal with their high interest rates and short repayment periods, then a major boost to their numbers is an obvious outcome.

As could have been predicted, therefore, the newly established MFIs in BiH began their life by whole-heartedly engaging with the small-scale trading sector, particularly involving cross-border trading ventures. Very quickly the portfolios of most MFIs were evidencing substantial operations supporting simple trading ventures. After a couple of years of operation, for example, the LIP’s client portfolio was dominated by small-scale trading ventures, making up 44 per cent of the total number of clients supported, amounting to 15, 652 individual businesses supported (World Bank, 1999), while even higher proportions of petty traders were involved in most other MFIs operating in BiH. As late as 2004, the distribution of microloans across BiH reflected the initial bias, for example in the RS as shown in Table 3.

Table 3. Distribution of microloans in the RS in 2004.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade</td>
<td>40%</td>
</tr>
<tr>
<td>Services</td>
<td>28%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>10%</td>
</tr>
<tr>
<td>Production</td>
<td>8%</td>
</tr>
<tr>
<td>Other</td>
<td>14%</td>
</tr>
</tbody>
</table>


BiH continues to experience a serious negative trade balance that is deeply damaging to its overall prospects for economic growth and development. As of 2004, the trade balance was in the red to the tune of around $US3.5bn. Of course, calculating quite
how much of this trade imbalance has been specifically precipitated by the working out of the microfinance model requires some serious econometric study. But most local economists agree that the instant spurge of imported goods into BiH after 1996 has been deeply damaging and it might have been better to have contained it. Even local analysts otherwise sympathetic to the microfinance model have expressed their concern that,

“Microcredit often permanently institutionalises the smuggling of goods and the widespread (though legal) importation of simple, low value added goods that would and could be better produced locally”41

Possible alternatives in 1996 might have been for the BiH government to insist on following the Italian government’s refusal to allow Marshal Plan (European Recovery Programme, ERP) funds in the late 1940s to be channelled into simple importing and trading ventures, but instead very successfully targeted at expanding the quantity and quality of small-scale manufacturing and industrial services ventures (see Weiss, 1988).42

3.5. Destruction of local social capital

Social capital is now seen as major factor in promoting successful local economic and social development, if not indeed the ‘missing link’ in development (for example, see Grootaert, 1997). An increasingly important facet of the microfinance model everywhere is its supposedly positive association with social capital. Some of the microfinance model’s success is down to its use of stocks of social capital, for example in group lending structures that enforce repayment from individual members. It is also said to be the case that the microfinance model is presumed to build social capital. For example, the constant interaction between people in the same lending group establishes trust and reciprocity.

However, it is also quite apparent that the microfinance model has an important capacity, perhaps more so, to actually destroy social capital.

42 However, private commercial banks were left free to underwrite the importing and trading sectors.
First, and probably most importantly, by re-casting individual survival as a function of individual entrepreneurial success, the bonds of solidarity, shared experience and trust that exist within poor communities are inevitably going to be undermined. This is a truism. But more specifically, whenever community development and support activities are recast as commercial and strict cost-recovery operations – a central operating principle of the microfinance model – the unavoidable consequence is a degeneration of the level of local solidarity, interpersonal communication, volunteerism, trust-based interaction and goodwill (Bateman, 2006). Note that this is also why social capital has declined everywhere where the state has withdrawn from the provision of important community support and development institutions and functions (Leys, 2001).

Second, the type of microenterprises associated with the microfinance model are, as we have seen above, often illegal, overwhelmingly informal and largely displaying a limited ability to creatively interact with other businesses. Yet outright illegality breeds fear and mistrust, while informality breeds a lack of respect for legal process, embeds a mistrust of government, and encourages the search for informal sources of protection and power in order to continue to do business. Most microenterprises are also very weak and small and very typically involve hyper self-exploitation (long hours, back-breaking work, little reward, undignified working conditions, little security of income, etc). Here, too, the end result is pretty negative. Hyper self-exploitation, insecurity and the ‘pulling oneself up by ones own bootstraps’ approach in general, inevitably generate alienation and antagonism towards the wider society that tolerates such conditions, especially if the far greater rewards enjoyed by others are illegally or unjustifyably accumulated, and such outcomes are unequivocally associated with the destruction of social capital.⁴³ In addition, the lack of regular

⁴³ The ideas put forward by some microfinance specialists (for example, Getubig et al, 2000:5) that the poor ‘need’ the respect and dignity that comes from ‘identifying and creating their own livelihood sources’ is, in my opinion, fundamentally mistaken. An excellent examination of the role of respect and dignity in the community, and the destructive consequences of its absence, is Sennet (2003). It should also be noted the World Bank’s ‘War on Poverty’ begun under Robert McNamara in the 1960s and 1970s was predicated only partly on a real concern for the poor, but mainly on the belief that the world’s growing population of poor and marginalised was becoming increasingly alienated and angry with society and might ‘turn to communism’ (see George and Sabelli, 1994). Accordingly, it would be naïve to think that the huge international community focus on microfinance today does not also involve similar underlying strategic political goals. These contemporary goals include the need to defuse the
inter-enterprise connections is associated with secrecy, an unwillingness to trust, little sharing, misunderstandings, and few social connections that might substitute for legal process. These major drawbacks to the microfinance model were certainly not lost on BiH economists, such as Čičić and Šunje (2002:168), who warned that,

“Very much as in Southern Italy, if the legitimacy of semi-legal, arbitrage-based occupational lifestyles is embedded within the local society and polity in BiH, it will eat away at the social capital upon which longer run business success will depend”

Third, the raft of MFIs established early on with the support of the international community generally received very warm appreciation from the local population. The MFIs and their personnel were said to be ‘there to help’ and ‘showing their sympathy with the local population’ by helping conflict-affected communities escape from their isolation and poverty. However, once many MFIs started the move out of the original market serving poor people and into new markets serving the less poor and emerging middle class and new business elite, and also out of providing microloans for business purposes and into microloans for consumption goods (e.g., cars, housing), attitudes began to change. They were just businesses all along. The increasing commercialisation and concern for its own survival thus began to chip away at the MFIs initially warm relationships with communities, key individuals and local politicians. While not exactly now seen as ‘part of the problem and not part of the solution’, nevertheless, the typical MFI is now increasingly looked upon in the community with some suspicion. Thus, over time the commercialisation inherent to the microfinance model in BiH will increasingly preclude popular legitimacy and voluntary support from the community, in sharp contrast to the pre-communist (Tomašević, 1955) and even communist-era (Horvat, 1976) community-based MFIs in the region that evinced significant popular support and community involvement (i.e. actually constructed social capital).

rising antagonism towards globalisation and the imposition of neoliberal structural adjustment policies everywhere, as well as to avoid the election of ‘pro-poor’ governments not particularly to the taste of the major western powers (see Bateman and Ellerman, 2006)
Finally, a worrying factor is the possible contribution to local inequality when, as is fairly typical of the microfinance model, just a very small number of micro-entrepreneurs ‘strike it lucky’ (and who are then used as role models by the MFIs and their supporters). As Robert Putnam acknowledges, rising inequality and social differentiation within the local community serves to greatly undermine social capital. Particularly when microenterprise success is established on the basis of illegality, informality and other sharp practises, the local community generally fails to accept any resulting inequality as legitimate. Such individuals are rarely social actors enjoying serious respect within the community.

4. Conclusion

There is evidence that the microfinance model in BiH has possibly helped to facilitate a number of poverty reduction impacts (albeit possibly just temporary) within the local community. However, there is much less evidence, if any, to suggest that the microfinance model correlates with the eventual facilitation of a sustainable ‘bottom up’ economic and social development trajectory into the longer term. In other words, the microfinance ‘medicine’ might indeed solve some of the short term problems, but it is like the bad medicine that first appears to cure the patient before ultimately killing them. In fact, the microfinance model is probably one of the better examples of what Ellerman (2005) has termed an “anti-development” intervention – an intervention that produces a number of short run benefits, which often underpin particular narrow political imperatives, but which actually undermines or sabotages sustainable economic and social development into the longer run. Given the huge financial and technical investment channelled into the microfinance model to date, likely to accelerate in the coming years as rising poverty and marginalization continue to destabilise developing and transition countries alike, the precise long term development contribution the microfinance model has played in the supposedly ‘best practise’ case of BiH deserves far more attention from independent researchers and analysts than at present.

44 For example, see Putnam (2000:294), where he concludes that “Inequality and social capital are deeply incompatible”.
45 See also Bateman and Ellerman (2006).
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