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A Second Look at Microfinance

The Sequence of Growth and Credit in Economic History

by Thomas Dichter

Executive Summary

Microfinance—the provision of financial services such as small loans to the world's poor—has grown in the past decade, extending billions of dollars in credit to tens of millions of people. A major aim of the microfinance movement is to provide funds for investment in microbusinesses, thus lifting people out of poverty and promoting economic growth.

Recent experience and the economic history of rich countries, however, suggest that those expectations are unrealistic. Most people, poor or otherwise, are not entrepreneurs, so there is little reason to think that mass credit would in general lead to viable business start-ups. Today as in the past, business start-ups in the advanced countries depend predominantly on savings and informal sources of credit; past forms of microcredit never played a role in small business development, and much microcredit is actually used for consumption rather than investment. In the history of today's rich countries, moreover, economic growth occurred first, then came credit for the masses. That credit was and is predominantly for consumption rather than investment.

There is no reason to believe that the nature and sequence of growth and mass credit are fundamentally different for poor countries today than they were in the past. We should not expect microfinance to noticeably affect growth or successful business development.

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History has a lot to teach us about the credit-for-everybody notions of microfinance.

Introduction

Microcredit—the extension of small loans to very poor people—has grown rapidly in the past decade, reaching tens of millions of individuals around the world and providing billions of dollars in loans.[1] From the very beginning of the microcredit movement, the presumption has been that the poor lack access to formal financial services, particularly to nonusurious credit. In some of the rhetoric of the movement, it has even been presumed that the poor are deliberately "excluded" from access to credit.

The response has been to democratize credit, providing access to all. Such access, it is thought, will enable the poor to work themselves out of poverty by investing in microbusinesses or asset acquisition, which in turn will feed into economic growth. Pick up almost any article on microfinance in the last 15 years (or more recently any microfinance website) and you will find assertions that reinforce this notion:

> The women I've met in Uganda and Guatemala are so resourceful, and it's just amazing to see how, with their courage and diligence, they create small businesses with such tiny amounts of money.[2]

> [T]he bank gave her a loan of . . . US$25. Such a small sum to start a business seems laughable, but this was no joke—this was "microcredit," designed for would-be entrepreneurs in poor areas.[3]

> Microcredit programs have successfully contributed to lifting people out of poverty in many countries around the world.[4]

The mission of the Microcredit Summit Campaign:

> Working to ensure that 175 million of the world's poorest families, especially the women of those families, are receiving credit for self-employment and other financial and business services by the end of 2015.[5]

> We have seen how access to loans and deposit services has empowered millions of people to work their way out of poverty. . . . Microfinance is a powerful tool to fight poverty. Poor households use financial services to raise income, build their assets, and cushion themselves against external shocks.[6]

Moreover, the 2006 Nobel Peace Prize winner and founder of the Grameen Bank, Muhammad Yunus, has famously called credit a human right.[7]

As many practitioners of microcredit (including this author) have learned, however, money is fungible—it can be used for anything. Although we knew that in the abstract, it became real as we began to see poor borrowers use their loans for what the industry has come to call "consumption smoothing," ironing out the highs and lows in cash flow so that crises can be met or large purchases made. But that very term suggests that the microcredit movement is not all that comfortable with the idea of "consumption" plain and simple, since it is implicitly recognized that making it possible for poor people to use credit for goods and services (even if some, such as medicine or education, are necessary) is not really what microcredit started out to do.

Those of us who work or have worked in microfinance in fact step gingerly around a number of things that underpin our work. We tend to skirt the question of consumption and spin euphemisms around the question of whether the poor invest their loans in business with terms like "microenterprise," "entrepreneurial agents," and "income-generating activities."

History—the history in the "north" of formal and informal credit use for business investment, and the history of formal and informal credit use for consumption—has a lot to teach us about the credit-for-everybody notions of microfinance. Its lessons might bring our expectations of microfinance more into line with reality. For the economic history of the rich nations strongly suggests that

- earlier forms of microcredit never played a significant role in business start-up or small business development,
- the first efforts at democratizing financial services were almost entirely savings and "thrift" based,
- economic development in fact came before (or at best alongside) the movements to democratize financial services, and
- when credit for the poor did come along, it *followed* the savings movement and developed almost entirely in relation to consumption.

If those lessons are valid, microcredit, still the dominant service in microfinance, seems to have long been on a path that does not lead to the kinds of results that a great many practitioners and advocates have hoped it would.

I will not deal here with the assumption that the poor are entrepreneurial. The distribution of entrepreneurial character is pretty much the same everywhere in the world. Some people have it, others do not. It is not surprising that many people think the poor in developing countries are nascent businesspeople; after all, most of them must take to the informal marketplace to generate small amounts of cash, and that is what makes them seem like they are engaged in business—but that is subsistence activity, a sort of default mode, and not what I call "real" business. If all other things were equal, one would see quickly and clearly that, as in the West, only a minority will make their careers as entrepreneurs.

Instead, this study is meant as a survey of the history of access to credit and its use in the advanced industrial countries during the main period of their development, beginning in the late 18th century and continuing into the mid-20th. The emphasis will be on North America and Great Britain, with some reference to Germany. But the subject and the literature are extensive, and a more thorough review could add much by looking at the rest of Europe and Japan as they became "developed."

Do the Poor Have Assets and, If So, How Do They Husband Them?

Since the credit-for-everybody notion is based partly on the belief that the poor need credit so they can build assets, we need first to look at the clients—the poor themselves. Did the poor in the past lack assets, and do they today? The problem is complex.

First, many of the assets of the poor, especially the rural poor, have been in the past, and are still today, *hidden* from view, often deliberately so, to avoid exploitation or expropriation. Read any novel about or description of peasant life from the 19th century onward and you will read of the peasant's capacity to hide what he has or what he has made from the tax collector, the landlord, or his neighbor. When houses were taxed on the number of windows, people built houses with no visible windows on the road side. When 16th-century farmers in the Alps paid their rent on pastureland with milk, they didn't milk their cows completely during the first milking of the day and used the excess milk taken during the second, nighttime, milking to make *reblochon* cheese. Likewise in rural India, China, Russia, or the United States, relatively poor people found (and find) ways to hide or underestimate their assets.

Many of the assets of the poor are *hidden* from view.

That understandable tradition fits rather well with the altruistic side of the microfinance agenda—it reinforces the belief that the poor are without assets, and much of our research on poverty does little to change that belief. When we do survey the poor prior to setting up a microfinance project, the research (because of time and funding constraints, and perhaps our ideology) is more often than not done too quickly and superficially to unearth anything more profound than the answers the poor want to give to the researchers. Only long-term field work (of the ethnographic sort that would require living in a village for two years or so) would enable us to penetrate the complexity of how the poor make, save, and use money and other assets.[8]

Of course, the fact that the poor sometimes hid assets does not mean they were rich. Indeed, they hid (and by extension "saved") assets *because* of their poverty, their vulnerability to exploitation and frequent indebtedness. And that poverty shaped some of their behavior, rendering them often cunning, conservative survivalists, who were forced by circumstance to find myriad ways to deal with crisis, periodic shortages, and, of course, death and taxes. Today's microfinance tends to see the poor somewhat patronizingly in one dimension: the poor are needy creatures, with lots of potential, to be sure, but with little resilience and few strategies or choices. If anything, the rural poor are seen even more simply than the urban poor. But things are not always what they seem.[9]

When the poor in the advanced countries began to have widespread access to formal credit, it was in fact for *consumption*, and indeed the wider accessibility of credit was driven more by the supply of consumables than by the demand for them. As for business development, when formal credit was involved, it was not accessed by the poor (who, if they wanted to start a business, used savings or borrowed informally from friends and family) but by established big business. Formal credit for business purposes, whether accessible or not, was not for poor folks, and as we will see, this was often by their own choice.

When the poor in the advanced countries began to have widespread access to formal credit, it was in fact for *consumption*.

Credit Use by Businesses in the Past

Historically, the way credit was used by real businesspeople (from merchants and traders in traditional bazaar economies to small businesspeople in later "firm" economies) is more complex than generally thought in today's microfinance circles. Credit for real business has been in the past, and is often today, intricately entwined with social structure and culture and with "rules" that often seem counterintuitive. As various historians, economists, and social scientists have shown, the way real entrepreneurs think about credit is different from the way the current microfinance framework sees enterprise credit—in linear, often black-and-white terms: "I need capital for my activity, I don't have it, so I have to borrow it, and when my business grows and or when I make my profit I will pay it back." That view is too simple. Consider the kind of local economy found in many developing countries, the bazaar economy. According to anthropologist Clifford Geertz, the traditional bazaar economy is a

> complex and ramified network of credit balances binding larger and smaller traders together. It is this network which provides the primary integrative factor in the [Indonesian] *pasar*, for it leads to a hierarchical ranking of traders in which larger traders give credit to smaller ones and smaller ones have debts to larger ones. These credit balances are only half-understood if they are seen only as ways in which capital is made available, for they set up and stabilize more or less persisting commercial relationships. . . . This is why, for example, traders often prefer expensive private credit to cheap government credit. . . . It gives them more than simple access to capital; it secures a higher position in the flow of trade.[10]

John Maynard Keynes once said that if you owe your bank 100 pounds, you have a problem, but if you owe a million, it has. The point is that *credit relationships in business can be complicated*, and the power-balancing and other optimization or positioning "games" involved in credit relationships are not easy to understand at first glance. It would seem that the businessperson and the poor microcredit borrower are two different kinds of people. The vast majority of today's microcredit program borrowers are more or less straightforward in their behavior: they want to pay back their loans and get out of debt.

In contrast, the smart *business* borrower wants to keep things on as much of a credit basis as possible. We see this occasionally in present-day microfinance projects when, for example, a going concern in India with a large turnover of say 500,000 rupees per month will take a 12-month loan of 20,000 rupees from a microfinance institution. The firm does not need this microcredit in any strict sense and could repay it instantly. Instead the firm is using the microcredit as an addition to a set of interwoven relationships with others, investing in what it believes (often wrongly) is a potential new relationship that will lead to a loan of a million rupees or more.

Formal Credit for Business: A Result of Economic Development, Not a Cause

Which came first, formal credit arrangements or growth in commerce and trade (i.e., economic development)? There is ample evidence that growth came first. In medieval Venice, for example, the commercial activity of traders who needed to expand their activity was financed by early forms of private banks, and in 16th- and 17th-century Mughal Empire India the evolution of a class of people who functioned as early "bankers" was likewise driven by the expansion of commercial activity. Those *sarrafs* supplied credit and undertook money transfers using bills of exchange called *hundi*.[11] Both the British and the Dutch East India Companies (early forms of multinationals) raised cash through the *sarrafs*. Clearly, once they reached a certain scale, formal credit and economic development became somewhat intertwined; but as will be explained later regarding start-up activity, the common source of capital was then (as it is still today) one's own resources and those of friends or family.

Indeed the role of banks in the early years of the Industrial Revolution in Europe, beginning in Britain in the last quarter of the 18th century, evolved in response to the demand on the part of expanding manufacturing and heavy industries, such as mining, metallurgy, and machine making, for short-term working capital, and many financial instruments were developed, including standing overdrafts.[12] The historical sequence seems to have been, first, the building up of an activity or sector, and then, a demand for formal business credit.

Small Business Start-ups Have Typically Preferred Informal Credit

In 1825 French writer Honoré de Balzac decided that the only way to control the publication of his books and ensure that he received the profits on their sale was to get involved in printing and selling them himself. He began an early version of a "vertically integrated" business, controlling everything from the writing, to the sourcing of the paper, to printing, advertising, and marketing. He needed funds, of which he was perpetually short. He borrowed first from his family and then from his mistress. The business worked for a while but ultimately had to be liquidated. When it was, he was in debt 60,000 francs, 50,000 of which was owed to his family.[13]

In 1923, soon after Walt Disney arrived in Hollywood, he and his brother Roy needed funds to launch Disney Brothers (which later became Disney Studios). They borrowed $25 from Roy's girlfriend and $500 from their uncle.[14]

Self-financing (savings) or borrowing from a close social network has generally been used for business start-ups, at least from the early days of the Industrial Revolution. As French economic historian Paul Bairoch points out, "[S]elf-finance was the dominant and almost exclusive form of business financing at the beginning of the Industrial Revolution."[15] Nonbank, informal sources of capital for business start-ups continue to dominate today, in advanced countries and developing countries alike. According to the Global Entrepreneur-

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ship Monitor, in a survey of 12 developed and high-growth countries (including the United States, the United Kingdom, Norway, Singapore, and Korea) in 2000, an average of 78 percent of funding for business start-ups came from informal sources.[16]

Why is that so or, better yet, why is it logical that it be so? Because start-ups are basically experiments undertaken in situ; they are undertaken not in a laboratory under "controlled" conditions but in the real world. Thus the results cannot be predicted in advance. Most people everywhere seem to recognize that reality, beginning with the entrepreneur, which helps explain the preference for self-financing or informal financing (or both), even when formal financing may be available. Because a loan from a friend or a relative is based partly on a social connection, the entrepreneur gains a hedge since he knows the arrangement is "softer," more "patient," more risk tolerant, and less return driven than a formal loan. In short, such loans are prevalent, not because of a lack of access to formal financing (even when such lack of access may be the case), but because they are *preferable to the borrower from a financial risk standpoint*—a friend or relative is more likely to take that risk than is a formal institution.

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Indeed, there is evidence, both from today's microfinance and from past efforts that arose out of altruistic or philanthropic instinct, that access to credit for business start-up on relatively easy terms *adds* risk to the already built-in risk of starting up—a risk inherent in the fact that the money was perceived as "easy," and thus less care was taken with how it was spent.

A striking example comes from mid-19th-century London and the journalism of Henry Mayhew, whose *Morning Chronicle* articles led to the idea of setting up a "loan office for the poor" a century and a half before the 2005 UN Year of Microcredit, which in effect advocated a worldwide "loan office for the poor." Through Mayhew's "loan office,"

> deserving subjects might obtain either small outright grants or loans on easy terms of repayment in order to obtain the necessary stock or equipment to carry on their trades. The sums advanced were petty and the number receiving them amounted to only a few score.
>
> The largest sum advanced on loan was to C. Alloway, the crippled seller of nutmeg-graters, whose portrait and harrowing story [in the *Morning Chronicle*] brought sympathy and recognition in the streets: "I am gazed at in the street," he wrote, "and observations made within my hearing with respect to the Exact likeness of the portrait." More than 9 pounds was advanced to him, to be repaid at 1 shilling a week, but he was beset at once with new disasters; he invested in a donkey, ordered a cart, and brought some hardware stock, but the donkey became ill, and the carpenter absconded with his money. The most ambitious effort of the "Loan Office" appears to have ended in failure.[17]

Historically, formal bank credit was used by established businesses—when a degree of "cruising speed" had been reached, or businesses were at any rate past the start-up stage, and thus something that a banker could have some trust in. Again there is considerable financial common sense to this, not just a bias for the "exclusion" of lower-income or poor people. It should be noted also that, certainly in the United States, the drivers of economic growth were not poor people getting access to enterprise credit but the expansion of big business and industry.[18]

The practical dividing line between standard microfinance clients of today (the vast majority of whom are *not* entrepreneurs) and real businesspeople is the line between consumption and investment capital for business. Credit for the masses has been in the past (and is today) largely for and about consumption. Credit for real business is not for or about consumption, *nor does it need to be accessible to everybody*.

As economic historians have suggested, many traders and merchants (not just in

Calvinist Scotland or Switzerland) are known for thrift and asceticism. They do not approve of excessive consumption (though once they become truly rich they might). Cash, when accumulated, is a business tool, enabling businesspeople to get into a new game, to be in on many different deals. And although the first attempts at expanding formal financial services to the poor were based on strong notions of thrift, the resulting savings were unrelated to business use.

Early Formal Finance to the Poor Was Based on Savings and Thrift

From the English "friendly societies" of the late 18th century to the early German credit union movement associated with Herman Scholze-Delitzsch in 1850 and Friedrich Raiffeisen in 1864, to the postal savings systems, experiments in formal systems aimed at the poor were based on savings.[19] Some of the promoters of those formal financial services, like Henry Duncan, who pioneered the Scottish savings bank movement in 1808, were what we would today call "social entrepreneurs," do-gooders who had a vision for the poor. Duncan and his followers in Scotland revealed their concern by using terms like "the debauchery of the alehouse . . . imprudent expenditures . . . working class improvidence" and the need for "moral restraint."[20]

There were also insurance schemes, friendly societies (which largely paid sick benefits), and the penny savings bank movement, begun in Scotland in 1810, and some of those also had a moral reform basis. As noted in Hay-thornthwaite, there was a "trend in Scotland towards penny savings banks and friendly societies as a means of training the population in the habits of provident care and self-denial."[21]

The very term "thrift" in early financial systems captures the moral basis of savings. In the United States, the popularity of Ben Franklin's *Poor Richard's Almanac* ("A penny saved is a penny earned") and the coining of the large copper penny in 1793 produced the rage for metal (and later mechanical) penny banks (aka "piggy" banks).

Henry Mayhew's 82 letters in the London *Morning Chronicle* from October 1849 to December 1850 are considered the most penetrating survey of poverty in England in the 19th century. They show clearly that the working poor used various savings mechanisms, despite the fact that they could not always hold on to the money.

A tailor:

> "When I came to work for the cheap show-shop I had 5 pounds 10s. in the savings bank; now I have not a half-penny in it. All I had saved went little by little to keep me and my family."[22]

A boot maker:

> "I had my £100 in the Four per Cents for a long time (I lent it to friend afterwards), and from £40 to £50 in the savings bank."[23]

In the 19th century, withdrawals from the wide array of financial systems for the poor—burial societies, building societies, cooperatives, penny savings banks, postal savings, and so forth—were for medical crises, burials, plots of land, retirement, wedding expenses, and so on, similar to what poor people in today's developing counties need cash for. There is, however, no suggestion in the literature that those loans were used entrepreneurially.[24]

There were also, of course, pawnbrokers, as evidenced by another of Mayhew's reports.

The wife of a painter:

> "I was obliged to sell a dish this morning, sir," said the woman, "to get the only meal of bread we have had to-day, and how we are to get another loaf I do not know."[25]

Whether or not the poor were improvident is not the issue of this paper. Of issue is

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The working poor used various savings mechanisms.

the fact that savings banks and other formal thrift-based financial service institutions often felt the need to teach the value of savings to the poor. More important, the poor who were the objects of those lessons were "working poor," they had income, but they needed ways (or others thought they needed ways) to put some of that income away for a "rainy day." It is significant that the early systems also instituted insurance programs, both for health and for life. Again, sequence is instructive here, since in the current microfinance movement, *everything seems to have been done the other way around*. The movement began almost exclusively with credit, then much later (and not always with enthusiasm) began to talk about savings, and only now are we beginning to hear talk about other services such as insurance.

Access by the Poor to Formal Credit Follows Savings and Is for Consumption

It is really not until the early 20th century that we begin to see a mixing of savings and credit. For example, in 1901 Alphonse Desjardins, a Canadian politician and businessman, imported the German credit union model to Quebec and created the credit union Caisse Populaire de Levis. In part through ties with French Canadians in New England, Desjardins also imported the model to New Hampshire in 1909. It was the first credit union in the United States. By 1925, 26 states had passed credit union legislation.[26]

When mass access to formal credit comes on the scene, it is for *consumption*. In 1910 the first "Morris Plan Thrift" was established in the United States. Morris Plan banks were perhaps the first true microcredit precursors since they were aimed at low- and middle-income households and were specifically designed to reduce the power of the money lender or "loan shark." Moreover, they used the concept of joint liability. A loan applicant did not have to put up collateral, but he had to have two cosigners who knew him, and those two people had to have similar earning power (i.e., be of the same economic class). But they were not guarantors of the applicant's loan—rather they were guarantors of his character. This solved the "asymmetrical information problem" and reduced transaction costs. It is significant that almost all borrowers were employed, that is they were wage earners, and that by 1910 the United States was already heavily industrialized. By 1931 there were Morris Plan lending institutions in 142 cities with an annual loan volume of $220 million.[27] Again, the sequence seems to have been, first economic development, then access by the poor to formal savings institutions, and then wider access to credit for consumption.

Morris Plan institutions were largely tied to consumption "needs," and they need to be seen in the context of the economic development of the time. Until the end of the 19th century most people in the United States made their living on the land, with a growing number working in industry. There was no appreciable "middle class"—there were farmers, merchants and traders, working people, and the rich (who increasingly derived their wealth from big business).

Farmers, who were poor in cash terms, often got their inputs through supplier credit, and wage income workers also managed their cash flow through forms of supplier credit (by running up "tabs" at a local grocery, for example). A great deal of exchange was still in the form of barter. What propelled the formal credit institutions was a combination of growing industrial productivity and technological invention, as well as the Progressive movement associated with Theodore Roosevelt, which led people to focus on the needs of the "little man." It was during the first two decades of the 20th century that all the *formal* innovations in democratizing credit access for the "little man" took place—credit unions, Morris Plan banks, and installment plan purchasing.

But the "little man" was not expected to start a little business. If he was not a farmer, he was expected to, and did, work for wages and to borrow money to buy the things that he didn't absolutely "need," consumer goods. In short, the little man, for whom mass credit was designed, was a product of the rise of wage labor, a product of the first fruits of industrialization, which was in effect the West's form of economic development. His role was not as a direct producer of economic growth but as a consumer of its fruits.

In the late 1920s President Hoover set up a "committee on recent economic changes," whose report came out in 1929. It noted:

> We have long since lost all fear concerning our food supply and so we no longer look on food as a luxury. . . . Our wants have ranged more widely and we now demand a broad list of goods and service which come under the category of "optional purchases."[28]

As economic historian Martin Sklar points out,

> Insatiable as the appetite for goods and services may have become, however, effective consumer purchasing power proved persistently insufficient to satisfy it, and at any rate, production capacity continuously out ran effective market demand.[29]

Sklar is among those who believe that installment and other forms of consumer credit took off in the 1920s to enable working and lower-income Americans to buy new things, and his belief is substantiated today in the fascinating marriage of banking and retailing exemplified by Elektra stores in Mexico. Elektra has already opened branches of Banco Azteca inside its stores to enable the poor to buy bigger-ticket items. The system is based on encouraging savings accounts and a cadre of inspectors who visit clients' homes to see whether their standard of living matches what was stated on their application. Wal-Mart Mexico is planning a similar system.[30]

Informal Credit Systems Were Complex and Used for Consumption

As opposed to formal credit systems, which developed in relation to the growth of consumption (and are relatively recent historically), *informal* credit systems probably go back to the beginnings of the use of money and to wherever there were shortages or crises. Such systems were about "making ends meet" when there were few state-supplied safety nets or risk mitigation mechanisms. Poor people were on their own and had few means to meet medical or other crises. There was also the hidden, yet apparently chronic, problem of meager earnings being diverted by men into alcohol or gambling—a pervasive problem in today's developing countries and one of the reasons behind the emphasis on targeting women borrowers in many microcredit projects. Thus, as is the case in today's poor countries, a "cash flow crisis" could occur weekly, or whenever a pay packet arrived home depleted or empty.

Mutual aid clubs of various kinds existed early on in the United Kingdom, and people moved into and out of them as a need arose, usually for a (relatively large) lump sum, or sometimes for cash-flow purposes. Here, again from Mayhew's interviews with London's working poor in the mid–19th century, is a boot maker, whose earnings had been hit by growing imports of French leather goods.

> "Why, sir, if it goes on this way, the workhouse stares us in the face. But the intention we have is to go into a club [a form of rotating savings and credit association, or in today's microfinance parlance, a ROSCA] this winter, and raise funds to emigrate to America."[31]

In working-class Britain in the first decades of the 20th century there was a great variety of informal credit options, as there was in the United States. A recent oral history project involving Belfast workers whose

Farmers, who were poor in cash terms, often got their inputs through supplier credit.

recollections go back to the 1930s is striking:

> Historically most working-class families were familiar with one or more of a list of credit suppliers which included the corner-shop "tick" [in U.S. parlance "tab"], credit drapers, pawnbrokers, tallymen, check traders, mail order agents, neighborhood money lenders, and hire-purchase [installment plan] traders.[32]

Moreover, credit strategies were equally diverse and multiple. No source of credit was a preferred source. In post–World War II Belfast, people still resorted to moneylenders when they reached their credit limits with the credit union. And strategies among networks of friends, acquaintances, and relatives were not only innovative but complex in their motivation. Altruism and social ties and, at the same time, profit maximizing and self-interest were all involved. O'Connell describes a co-op store in Belfast that many community members belonged to because they could buy on credit and get a dividend each quarter as long as their debt was paid in full before the dividend date (called the co-quarter). There was a practice of lending co-op membership books to friends, neighbors, and relatives, which allowed them to buy goods on credit from the co-op and repay the book's owner when the co-quarter was due. In this way the owner of the book received a larger dividend because of the increased purchase volume, which was also effectively a form of interest on the loan of the book.

Informal credit systems could also be gender specific. There were systems for women (based on neighborhoods and streets within them) and informal credit systems for men based on their particular workplace. These were in effect common bond arrangements with both an economic and (in today's terminology) a "social capital" function.

Mutual aid clubs of various kinds existed early on in the United Kingdom.

But again, as with formal credit, all the "little people" who had access to consumer credit were either savers or wage earners, or both. They were not microentrepreneurs, nor did they use their credit to start businesses or as working capital. The growth in credit came about in order to promote and smooth consumption.

The United States Today: Democratized Credit Is Still Used for Consumption

The U.S. Federal Reserve has kept data on outstanding U.S. consumer credit since February 1943, at which time it totaled $6.577 billion. That was entirely nonrevolving credit (auto loans, installment plans, etc.) and did not include mortgages. Credit cards were not in widespread use until the 1960s, and that is reflected in the fact that the Federal Reserve did not record credit card debt until January 1968, when the figure (under the heading of revolving credit) was $1.316 billion. By June 2006 that figure had increased more than six-hundred-fold, to $820.65 billion, while total consumer credit had reached $2.186 trillion, having crossed the $1 trillion threshold in January 1995.[33]

By mid-2006 there were approximately 1.2 billion credit cards in the hands of American consumers, a number equal to four cards for every single person (woman, man, and child) in the United States. It is hard to imagine a greater democratization of credit, but it is critical to acknowledge that this is largely consumption credit, and as a result of this easy "credit for everybody," approximately half of all credit card holders in the United States do not pay off their balance every month and are thus in perpetual debt (we will leave aside how such a situation would look if the banker's risk assessment tool of "PAR-30"—Portfolio-at-Risk over 30 days in arrears—were applied).

Finally, the savings rate of the United States reached 0 percent in mid-2005, the lowest rate since 1933 in the depths of the Great Depression. Although the longer-term consequences of this phenomenon are still unknown (the United States is at best barely two generations into it), some people foresee, rightly or wrongly, negative economic and social ramifications of easy consumer credit and low savings. Surely that state of affairs is not what Muhammad Yunus envisions when he says that credit is a human right.

Conclusion

History seems to be telling us that credit and savings services and their role in development have not really changed. The average poor person in the past (and today) is not an entrepreneur, and when he or she has access to credit it is largely for consumption or cash flow smoothing. The average entrepreneur prefers to start with informal credit or savings rather than formal credit. The best financial services for poor or low-income people are savings-based services, which in their pure form do not need outside financial help, or for that matter the large microfinance industry that has evolved.

Indeed, in the microfinance world of today, it is increasingly understood that savings is also the basis for the microfinance institution's (MFI's) ultimate health.

> The MFIs that favour savings argue that the self-sustaining threshold is more surely, and in the end more rapidly, reached when the investment cycle is fully financed from the savings of its members.[34]

The case of Bank Rakyat Indonesia's Unit Desa system is a good example of a major microfinance success that used hardly any outside resources as a basis for the financial corpus. There are other, less well-known, MFIs, such as India's Community Development Foundation, based on member "thrift societies" that receive no help from the microfinance industry.

Most important, history seems to be telling us that economic development and its consequent massive poverty reduction did not depend on microcredit being made more accessible for income production or asset acquisition by the poor. Instead, it was the process of development that created jobs, which in turn made the working poor an attractive target for financial services, beginning with savings and then moving toward consumption so that the goods produced would have a wider market.

Although the same exact sequence does not necessarily apply in today's different world, and some key parameters have changed dramatically (e.g., technology and automation will inevitably reduce the labor intensiveness of industry even in the poorest countries), there is no compelling reason to think that the underlying dynamic of development does not still apply. As the late British development economist Peter Bauer said, "To have money is the result of economic achievement, not its precondition."[35]

Capital, especially the lending of it, is, after all, what most of microfinance is about. And we in the microfinance movement have indeed assumed that it is a precondition of development. If it is not, and history seems strongly to suggest as much, we need to radically reduce our expectations about microcredit and thus better align ourselves with reality.

Notes

1. Microfinance (MF) is the current, more comprehensive name of a movement that began by calling itself microcredit. Although credit still represents the lion's share of the financial services offered under the name microfinance, the newer name is meant to convey that the field now also promotes savings, insurance, and remittance transfers. A microfinance institution (MFI) can be a bank, a nongovernmental organization, a nonbank financial institution such as a finance company, or a cooperative such as a credit union. Because of the expanded definition of MF and the wide range of institutions, it is difficult to gauge accurately the extent of the industry. Organizations such as the MicroCredit Summit Campaign, whose mission is to promote microfinance, claim that MF reaches close to 100 million poor families. The Microfinance Information Exchange (MIX), http://mixmarket.org, estimates roughly 30 million credit clients worldwide. There are currently 818 MFIs registered with MIX. At the end of 2005, of 488 MFIs reporting data, 92 percent had fewer than 100,000 active borrowers. Of those same 488 only 5 organizations (4 of which are in Bangladesh) reported more than 1 million clients.

2. Natalie Portman, actress and spokesperson for

Economic development and its consequent massive poverty reduction did not depend on micro-credit being made more accessible.

the International Year of Microcredit, http://www.yearofmicrocredit.org/pages/whosinvolved/whosinvolved_patronsgroup_portman.asp.

3. Larry Baum, "The Year of Microcredit," *Human News*, September 29, 2005, http://ideaexplore.net/news/050929.html.

4. United Nations Department of Economic and Social Affairs, http://www.un.org/esa/.

5. http://microcreditsummit.org.

6. Brigit Helms, *Access for All, Building Inclusive Financial Systems* (Washington: Consultative Group to Assist the Poor, World Bank, 2006), pp. ix, xi.

7. He has made that statement many times since the 1980s, most recently in Muhammad Yunus, "What Is Microcredit?" August 2006, http://www.grameen-info.org/bank/WhatisMicrocredit.htm.

8. Hernando de Soto makes the important point that poor people's assets are not represented in the same way as those of the rich. See Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

9. On the complexity of peasant life, see, for example, the work of Soviet agricultural economist Alexander V. Chayanov, *The Theory of Peasant Economy*, ed. by D. Thorer, Basile Kerblay, and R. E. F. Smith (Madison: University of Wisconsin Press, 1986), or John Berger, *Into Their Labours: Pig Earth, Once in Europa, Lilac and Flag: A Trilogy* (London: Granta Books, 1992).

10. Clifford Geertz, *Peddlers and Princes* (Chicago: University of Chicago Press, 1963), p. 36.

11. Ishrat Alam, "Sarrafs (Bankers) in the Mughal Empire," paper presented at Session 106, 14th International Economic History Congress, Helsinki, 2006.

12. David S. Landes, *The Unbound Prometheus: Technological Change and Industrial Development in Western Europe from 1750 to the Present* (Cambridge: Cambridge University Press, 1969), pp. 74–75, 154.

13. See Honoré de Balzac, *Le Médecin de campagne* (Paris: Editions Gallimard, 1974), preface by Emmanuel Le Roy Ladurie, notes by Patrick Berthier, p. 333.

14. Anthony Lane, "Wonderful World: What Walt Disney Made," *New Yorker*, December 11, 2006, p. 69.

15. Paul Bairoch, *Le Tiers-Monde dans l'impasse, Le Demarrage economique de 18eme au 20eme siecle* (Paris: Gallimard, 1992), p. 95.

16. Paul D. Reynolds et al., *Global Entrepreneurship Monitor—2000 Executive Report* (Kauffman Center for Entrepreneurial Leadership, Babson College, London Business School and Ernst & Young, 2000), p. 29.

17. E. P. Thompson and Eileen Yeo, *The Unknown Mayhew* (New York: Pantheon Books, 1971), p. 43.

18. There is an interesting line being crossed today in the United States between small business start-up or working capital and consumer credit, and that is the use of credit cards, which can be "maxed out" often to $10,000 or $20,000, to supply high-interest-rate cash injections to the business. It is significant that credit card companies actively discourage that habit, suggesting that it is not a good way to finance a business.

19. For more detail, see Hans-Dieter Seibel, "Does History Matter? The Old and the New World of Microfinance in Europe and Asia," paper presented at "From Moneylenders to Microfinance," an interdisciplinary workshop, Asia Research Institute, National University of Singapore, October 7–8, 2005.

20. Timothy Alborn, "The Thrift Wars: Savings Banks and Life Assurance in Victorian Britain," unpublished paper, New York, Lehman College, City University of New York, n.d.

21. J. A. Haythornthwaite, *Scotland in the Nineteenth Century, An Analytical Bibliography of Material Relation to Scotland in Parliamentary Papers, 1800–1900* (Aldershot, UK: Scolar Press, 1993), p. 114.

22. Thompson and Yeo, p. 222.

23. Ibid., p. 241. Note that "Four-per-Cents" were government debentures, in use in Britain as early as the 17th century. They were also used in the United States. Though they do not appear to have been much used by poor people, clearly some "working-class" British did make use of them.

24. P. H. J. H. Gosden, *Self-Help: Voluntary Associations in 19th Century Britain* (New York: Barnes and Noble, 1974).

25. Thompson and Yeo, p. 261.

26. Today there are 8,853 credit unions in the United States with more than 87 million members and $700 billion on deposit, according to the New York State Credit Union League and Affiliates website, http://www.nyscul.org/News/factsheet.htm.

27. Ronnie J. Phillips and David Mushinski, "The Role of Morris Plan Lending Institutions in Expanding Consumer Micro Credit in the United States," research paper, Colorado State University, March 2001.

28. Quoted in Martin J. Sklar, *The United States as a Developing Country* (Cambridge: Cambridge University Press, 1992), p. 166.

29. Ibid.

30. "Underwear and Overdrafts," *The Economist*, November 25, 2006, p. 102.

31. Thompson and Yeo, p. 240.

32. Sean O'Connell, "Credit, Class and Community: Working Class Belfast 1930–2000," research paper, University of Ulster, UK, School of History and International Affairs, 2004, p. 8.

33. See U.S. Federal Reserve Board, http://www.federalreserve.gov/releases/g19/Current/.

34. Jacques B. Gélinas, *Freedom from Debt: The Reappropriation of Development through Financial Self-reliance* (London: Zed Books, 1998), p. 120.

35. Peter Bauer, *From Subsistence to Exchange and Other Essays* (Princeton, NJ: Princeton University Press, 2000), p. 6.

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