



# THE INS AND OUTS OF INCLUSIVE FINANCE: SOME LESSONS FROM MICROFINANCE AND BASIC INCOME





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## Abbreviations and acronyms

<b>BI</b>	Basic Income
<b>CCT</b>	Conditional Cash Transfer
<b>CEO</b>	Chief Executive Officer
<b>CLP</b>	Caja Laboral Popular
<b>CGAP</b>	Consultative Group to Assist the Poor (World Bank)
<b>FDI</b>	Foreign Direct Investment
<b>FSD</b>	Financial Sector Deepening Kenya
<b>GDP</b>	Gross Domestic Product
<b>IFC</b>	International Finance Corporation
<b>ILO</b>	International Labour Organisation
<b>IPO</b>	International Public Offering
<b>ISO</b>	Import Substitution Industrialization
<b>LAPO</b>	Lift Above Poverty Organization (Nigeria)
<b>MCC</b>	Mondragon Cooperative Complex
<b>MCI</b>	Microcredit institution
<b>MIV</b>	Micro-investment vehicle
<b>NAFTA</b>	North American Free Trade Agreement
<b>NGO</b>	Non Governmental Organisation
<b>OECD</b>	Organisation Economic Cooperation and Development
<b>QE</b>	Quantitative Easing
<b>RCC</b>	Rural Credit Cooperatives
<b>RCT</b>	Randomised Control Trial
<b>SCI</b>	Special Credit Institutions
<b>SME</b>	Small and medium enterprise
<b>TVE</b>	Township and Village Enterprises
<b>UCCS</b>	Urban Credit Cooperatives
<b>UCT</b>	Unconditional Cash Transfer
<b>UN</b>	United Nations

## About the authors

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et al, and steering BIEN), and being an academic. He is on the editorial boards of various academic journals, including *Development and Change*, *Work, Employment and Society* and the *Indian Journal of Labour Economics*. He has been invited to give lectures in over a hundred universities around the world, and has twice been invited to be a speaker at Davos.

His recent books include *The Precariat: The New Dangerous Class* (2011), translated into 20 languages; *A Precariat Charter* (2014); with others, *Basic Income – A Transformative Policy for India*, and *The Corruption of Capitalism: Why Rentiers Thrive and Work Does Not Pay* (2016). His latest book is *Basic Income: And how we can make it happen* (Pelican, Penguin, 2017).

### **Illustration credits.**

The illustration of a woman enslaved by microcredit (Page 9) was in part derived from an illustration titled “Femmes, dette et microcredit”, which was kindly provided by Mr Eduardo Luzzatti. He initially produced it for the CADTM (Committee for the Abolition of Illegitimate Debt) seminar in Bamako, November 2017.

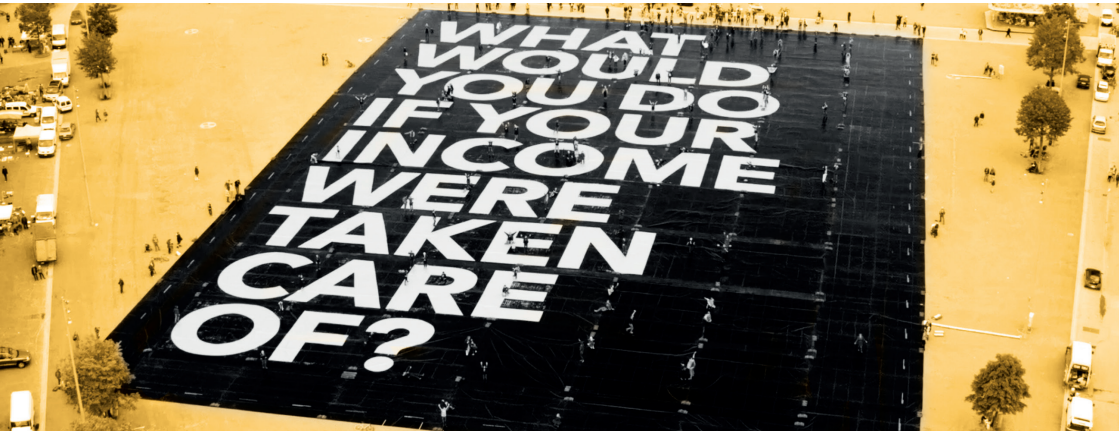
The illustration of the 8000 square metre poster “What would you do if your income were taken care of?”, used on the cover and in several pages was derived from a photograph kindly provided by Generation Grundeinkommen. The poster was laid out in public squares and streets during the Switzerland referendum in 2016 on Guaranteed Basic Income.

The picture of villagers in a basic income pilot study in Madhya Pradesh (Page 49), India, was provided by chapter author Guy Standing. It was initially produced by SEWA MP in partnership with the India Network for Basic Income, as the cover for a short video that can be accessed on <https://youtu.be/i-pP9qRwvHM>





# STARTING WITH THE POOR<sup>1</sup>



Diana Barrowclough

## 1. Introduction

For obvious reasons much of the debate about development finance focuses on big money, how to raise the billions of dollars needed to fund infrastructure or other long-term investments. However, increasing attention has in recent years been given to the other end of the scale – how to secure finance for the poor. There are around 750 million people in the world trying to live on less than \$1.90 per day (the World Bank's definition of extreme poverty) but many more struggle on what countries themselves define as a national poverty level and rising poverty levels are a concern in some of the world's richest countries as well. Moral and social concerns about impoverishment get an additional twist with the knowledge that leaving people in abject poverty can choke the domestic market and put a brake on government efforts to boost their economies. Small increases in the incomes of billions of poor households may not seem as newsworthy as raising the billions of dollars needed for infrastructure, but the human impact on health, welfare and happiness can be profound, and in fact both need to go hand in hand to build more sustainable and inclusive economies. This compendium examines these issues through two papers commissioned by UNCTAD in 2017 to examine the development potential of innovative financial mechanisms aimed (directly or indirectly) at securing finance for the poor<sup>2</sup>. Both the Basic Income (BI) mechanism and the various mechanisms grouped together under the term 'Microfinance' have long histories and a surprisingly broad political appeal (even if this tends to break down once it gets to the finer details). Both are highly topical right now as the development community appraises and reappraises their historical experiences and their future potential.

The basic income concept is on a rising wave, with a number of developed and developing countries seeing it as a brave new tool for the 21<sup>st</sup> century -- notwithstanding the fact that it first appeared more than 500 years ago. It has resurfaced at regular intervals (Atkinson 2003) but is attracting global attention on an unusual scale at the current time (Varoufakis 2017, Standing 2017). In this volume, Guy Standing and Ian Orton argue that universal transfers of cash such as the BI can and should be used in developed and developing countries alike to attack poverty, inequality, joblessness and the many social and health scourges that accompany economic insecurity. They see it also as a mechanism to serve counter-cyclical macroeconomic functions of managing consumption and aggregate demand; citing examples in the United States and Australia where putting more disposable income into the hands of low and middle income groups after the 2007-2008 financial crisis had the effect of limiting the effects of the economic downturn and constituted an important part of the exit strategy.

Today's BI vision of unconditional, universal payments made to everyone, regardless of age, gender or even income is argued to be more efficient and more equitable than previous cash transfer systems which were highly targeted and where payments were conditional and made only to the selected few (and often not the ones intended.) The concept of a payment to everyone, regardless of their individual characteristics or situation, has become particularly compelling for many other supporters across the political spectrum as the rise of automation, robotics and digital technology is raising fears about permanent job losses at worst and a shock to employment at best. It also addresses the fact that in today's society, the ability to buy things, to be a consumer, is such a part of social relations that being unable to participate in this aspect of life adds yet another dimension of poverty, on top of the concrete effects such as homelessness, poor nutrition and lack of education. It acknowledges that all citizens played a role in generating the wealth that currently is enjoyed by too few. For those who worry it is wrong to pay a basic income to the non-poor, their payments can be clawed back retrospectively through the tax system. That method is cheaper and more equitable than the problems associated with targeting. Others however raise valid fears this positive concept will be distorted, if it is used as an excuse to remove other vital forms of public support and public services. Of course, if that is the case, then the expected benefits would not occur; indeed things could become worse.

While the BI is a cash payment made typically in the form of a grant -- "money for nothing" with no expectation of its being repaid -- Microfinance is a very different kind of instrument, being a business loan given in the full expectation that it will be repaid. What makes Microfinance different from commercial lending is that it is targeted explicitly to the poorest; in principal, a community that is usually unbanked, with no credit history, and to whom traditional lenders either refuse to lend or will lend only at cripplingly high loan-shark rates. Microfinance thus began its life with a somewhat charitable hue; often with loans at concessional rates although always linked with a market-philosophy. The idea was that donors could provide subsidized or cheaper loans to seed-fund micro businesses or individual entrepreneurs; they could rely on repayment because powerful social controls would support the lenders and ensure they did not default on the loan (many MFIs lent only to groups comprising women). At one time, this was one of the most highly funded anti-poverty strategies in the global south. However, Milford Bateman paints a disturbing picture of its fall from grace. From very modest local roots, microfinance became a multi-billion dollar global financial industry, growing extremely large and far from its initial vision. Its role as a development tool is now being reappraised amid concerns that it not only failed in its quest to reduce poverty but may, for a number of reasons, make matters worse.

Timing is also a feature, and the debate about microfinance and basic income is heightened by advances in digital technologies, internet and mobile-telephony payment

systems. These have played an essential role in their economic prospects as a tool to reach the poorest, because it is now so much easier and cheaper to reach out to billions of poor households that in the past had been expensive or difficult to serve. This trend will likely continue and gain further momentum as the development community aims to meet the Sustainable Development Goals and tech and financial communities are attracted to meet new business opportunities. The challenge is to ensure that such so-called 'inclusive finance' really does make a better world and is not subsumed by other less benign forces. To this end, the following papers and their authors speak for themselves. However, from UNCTAD's perspective – being wedded to the principle of equitable, inclusive development whilst remaining independently open to examining different approaches to achieve it - there are valuable lessons to learn from these two policy mechanisms and experiences with their use.

## 2. What went wrong with microfinance?

It is always a problem to place too many and too high expectations on a single mechanism. Microfinance was expected to be a panacea. But, standing back from the hype, it should be obvious that lending very small amounts of money (usually less than \$100) to individual entrepreneurs-to-be is unlikely to be able to generate jobs and create a dynamic market on the scale needed to fundamentally change the economic environment, even at a very local level. Indeed the fact the level is local is part of the problem – many microfinance loans were financing small-scale trading and could even be displacing other traders or provoking a shift towards informal employment. Lending to the poor can only ever be one aspect of a broader and deeper approach whereby governments tackle directly the issue of job-creation, skills development, trade and development rather than imagining that anyone or everyone can be an entrepreneur.

Another lesson is that the partly charitable ethos out of which Microfinance was borne became co-opted and even perverted, as another facet of the dominance of financialization of the period from the 1980s onwards – as well documented in various *Trade and Development Reports*. Microfinance had always been strongly linked to the concept of markets, but in its early years there was also an assumption that donors would support the institutions, usually by providing subsidized capital as well as financing the costs of operations. Quite quickly however it seemed donors could support the poorest of the poor *and* get their initial seed-funding repaid, a win-win policy that would enable them to sustain and even expand their aid efforts. The fact that the recipients of loans were paying back sometimes very high interest rates (above 50% was not uncommon) was questioned much less than it should have been, because the industry focused often on financial performance but not much on social performance.

High interest rates excluded the poorest and favoured those who were “poor but not-so-poor”; other problems included adverse selection, group bullying and the threat of excessive debt.

By the early 2000’s, even the idea that donors should help subsidise the process became questioned as microfinance had morphed from donor-aid, to a donor activity with full-cost-recovery, to a commercial venture. A conference on microfinance and public policy organized by this author in the early 2000’s was swimming upstream for reappraising the overall concept and arguing it was ‘smart’ to use subsidies to support developmental lending and detrimental to follow financial imperatives more applicable to commercial lenders.<sup>3</sup> (Barrowclough 2003). It called for donors and the development community to accept the fact that if microfinance was to support the poor, it would continue to be subsidy-dependent. This view was not wide-spread and eventually the microfinance industry became part of wider trends of global financialization, with microfinance services provided by a deregulated, profit-driven global industry that became, according to Bateman in this volume, marked by fraud and other deceptive practices (see also Bateman, Blankenburg and Kozul-Wright, 2018.)

Another lesson learned from the experiences of other countries is that even in the case where a deep and broad financial services market exists, a diverse range of sources of small-scale business finance is needed, such as cooperatives, development banks and credit unions standing alongside profit-making commercial lenders (see also TDR 2015). Moreover, their business loans for the poor will likely work better when integrated with other non-financial aspects relating to business development. Bateman describes how, in post-war Europe, financial cooperatives in Italy, Germany and Spain offered loans that were supported with training, business planning and other technical support, helping to re-build small industries and promoting bottom-up industrial development. Similarly China’s rural and urban credit cooperatives provided financial backing for government owned and industry based Township and Village Enterprises; or microloans for families in Vietnam that were supported by local government provision of quality services such as irrigation and agricultural extension services, that enabled farmers to quickly scale-up to be more productive.

Related to this, another lesson from the microfinance experience that remains important for the future concerns the tradeoff between social goals and financial ones, which is real and dynamic. It is an issue yet to be resolved also in today’s much larger national, regional and multilateral development banks, as well as other financial mechanisms such as Public Private Partnerships. Any developmental mission can drift off course as organisations respond to what is measured – meaning that social goals need to be

explicit in order to be pursued. Microfinance became more profitable and was rolled out in many more locations and countries, but it was not evident what benefits were getting to the poor. According to the Bateman paper in this volume, things in fact went strongly in the other direction, in part because these indicators were not the ones measured. Narrowly 'financial' but not truly 'economic' performance dominated. These lessons are worth remembering in light of today's efforts to meet the Sustainable Development Goals because for many donors in the past, support for MFIs was driven by hopes it would help realise the Millennium Development Goals of reducing the number of poor by 2015.

### 3. Money for nothing – some lessons from Basic Income

In contrast to microfinance, the BI concept is at heart universal rather than targeted, and it is a grant for living not a business loan to be repaid. It has a long history, going back as far as Thomas More's *Utopia* published over 500 years ago, and has resurfaced at regular intervals over the last century (Atkinson, 2003). According to some, its principal is enshrined in Article 52 of the Universal Declaration of Human Rights (Bregman, 2017). Uniquely, BI has political support from opposite ends of the political spectrum. Milton Friedman on the right linked it with ideas of reducing the role of the State with respect to regulation or welfare, and John Kenneth Galbraith and others on the left associated it with redistributive justice and social solidarity. Others see it as a means to survive and even thrive in a "post-work world", or to respect gender equity calls for payment for unvalued household and care work (see Trade and Development Report 2017, pg 162). With such high hopes, and highly contradictory ones, it is obvious that the details matter greatly. Indeed, this wide political support can break down once the actual numbers (how much money, how many recipients) are on the table. On the other hand, Standing and others argue that even at low amounts, and even for short periods of time, BI has been shown to provide positive development benefits<sup>4</sup>.

Hence in parallel with some of the criticisms laid against microfinance, one lesson is that BI alone cannot be a panacea either, and if too many hopes are placed on it, the outcomes can only be disappointing. Some of today's supporters of BI are careful not to promise it can be the whole answer to the problems of poverty, inequality or joblessness, and stress that it will need to be delivered alongside other essential public services and benefits and not as a replacement. Some argue that even at small levels, and over short periods of time the developmental impact on households can be positive (Davala 2017). Ideally though, BI too needs to be part of a wider, integrated approach

owards job creation, reducing inequality, fairer sharing of the benefits of growth, trade and development.

As described by Standing and Orton's paper in this volume, several developing countries have already been experiencing positive impacts of rolling out this mechanism, even at low levels. Some developed countries have already been doing it successfully for a long time -- in Alaska, when the Permanent Fund that pays an annual income to State citizens was established, the poverty rate and Gini measures of inequality were the worst in all US states; however, twenty years later, they were the lowest. These positive examples are timely from a historical perspective where the nature of work and the expectations of working life are changing. Standing and Orton argue that if the 20<sup>th</sup> century was the century of social rights, the 21<sup>st</sup> century is to be the century of economic rights, and one of the most fundamental economic rights is the right to basic income security and the right to have enough on which to live.

Some have contended that universal employment programmes would contribute more directly to poverty alleviation and improving distribution in developing countries but in fact there does not need to be a binary choice, both policies serve different aims and could be used in conjunction with each other. Moreover, the rise of automation and robotics is changing peoples' hopes and expectations of work, possibly forever. BI does not imagine that everyone can be an entrepreneur, an SME or even an employee, it accepts the fact that some people may never work, but insists they have the right to dignity and to participate in economic and social life. Inclusion in this sense means also having some basic disposable income, in addition to the other necessities of life. In so doing, this may also support parallel efforts of job creation as the recipients of BI become the consumers that are needed just as much as the producers. With BI, everyone can benefit from advances in new technology, the gains created through robotics or automation can be shared with everyone.

The challenge then is to properly nest it within the other policies that are needed for development. Basic Income must not become a 'stalking horse' used as to conceal the reduction or removal of other public goods and services. It should be a complement not a replacement of other vital forms of support. And, if the experience of microfinance is anything to go by, we may also need to protect it from being co-opted or diverted by other more financialised objectives, and keep a strong focus on its social impacts.



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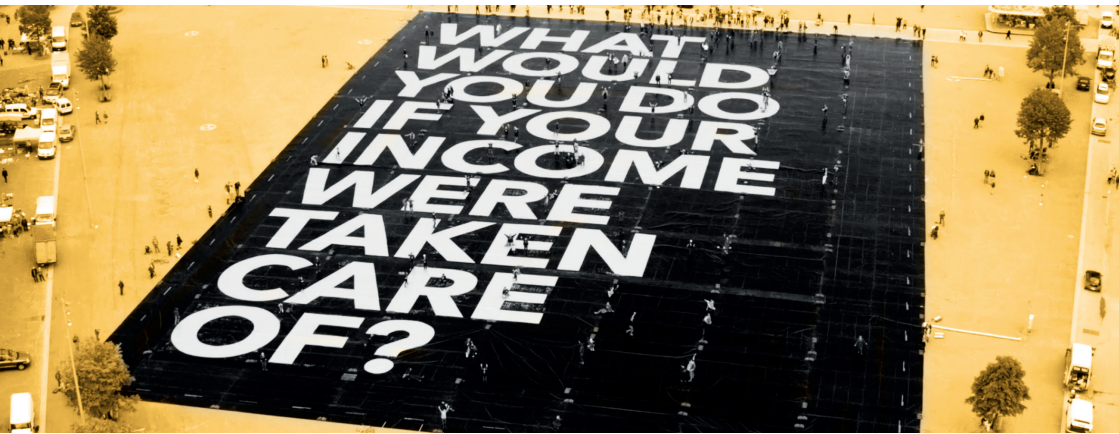
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## Endnotes

1. This introductory chapter benefitted from comments from Richard Kozul-Wright (Director, Division on Globalization and Development Strategies UNCTAD) and general comments from colleagues during discussions regarding Chapter 7 of the Trade and Development Report 2017, but opinions and any errors are the author's own.
2. UNCTAD commissioned both of these papers in 2017 as part of background research for the Trade and Development Report 2017 'Beyond Austerity: Towards a Global New Deal' and for the Development Account project 'Strengthening pro-growth macroeconomic management capacities'.
3. Conference 'Microfinance and Public Policy', 20-21 November 2003; sponsored by the Geneva International Academic Network (GIAN), Capability and Sustainability Centre, University of Cambridge, and ILO.
4. Standing (2018) cites an example of a pilot scheme in nine villages in India.



# FROM PANACEA TO “ANTI-DEVELOPMENT” INTERVENTION: THE RISE AND FALL OF MICROCREDIT



Milford Bateman

## 1. Introduction

Microcredit is the provision of a small loan – a “microloan” – to the poor in order that an individual can establish an income-generating project, thereby escaping poverty.<sup>1</sup> The concept was brought to the world’s attention by developments in the 1980s in Bangladesh, notably involving the tireless personal effort of Bangladeshi economist and future (2006) Nobel Peace Prize co-recipient, Dr. Muhammad Yunus. The microcredit model caught on very quickly because it almost perfectly reflected the *zeitgeist* of the time. The election of Margaret Thatcher in the United Kingdom in 1979 and Ronald Reagan in the United States of America in 1980 had ushered in the neoliberal era, which was defined by a rediscovered belief that private entrepreneurship, self-help, and exclusively market-driven outcomes were the core drivers of economic growth (Hayek 1945). Microcredit could hardly fail to be a popular intervention among neoliberal policymakers and, indeed, it went on to become one of the most popular pro-poor development policies of all time. The microcredit model provides the tiny loan sums required to assist the poor in the global south to move *en masse* into petty entrepreneurship projects and self-employment, and so, it was thought, out of poverty.

But from mid-2007 onwards the microcredit sector ran into a wall of bad news. In all of those locations across the global south where the microcredit industry has gained the strongest foothold, no real incontrovertible evidence of net positive poverty impact has been located. As high-profile microcredit advocate, David Roodman, was forced to concede, “On current evidence, the best estimate of the average impact of microcredit on the poverty of clients is zero”.<sup>2</sup> Compounding this problem was the fact that the microcredit model became associated with a range of other serious problems, notably increasing over- indebtedness, informalization, vulnerability, individual impoverishment, “microcredit meltdowns”, fraud and unethical behaviour. Meanwhile, standing in stark contrast to all these adverse outcomes, are the often-spectacular financial returns enjoyed by a narrow financial elite *supplying* microcredit.

By the late 2000s it began to appear that the microcredit model did not, in fact, represent an advance in the search for a sustainable poverty reduction and local economic development model. Yet, even so, the international development community refused to renege on its long-standing commitment to the microcredit model. It instead shifted the “goal-posts” as part of a major rescue effort, creating a completely new objective for the microcredit industry to pursue. The microcredit model was no longer all about poverty reduction directly, but was to be about achieving what has been termed “financial inclusion”, a very much wider agenda that is today attracting as much passion, dedication and resource commitment as the microcredit model once enjoyed.

This paper summarizes why the microcredit model very rapidly rose to almost universal acclaim, but then from around 2007 onwards its reputation was destroyed almost as quickly. It briefly adumbrates the most fundamental problems and flaws inherent to the microcredit model as it has emerged since the 1980s. It also explains why the microcredit model has received such dedicated support and helped to survive in recent times in spite of its manifest flaws and all too often calamitous impacts on the very people – the global poor – it was initially held up as helping to escape from generalized poverty and under-development.

The rest of the paper is structured as follows. Section II provides a little background to the rise of the microcredit industry. Section III provides the main body of the paper, describing five inter-linked areas where the microcredit model has seriously fallen down in actual practice. Section IV is a brief discussion of what alternatives to the microcredit model exist and, in fact, are now urgently required as the global south is expected to be swamped by microcredit in the coming years thanks to new digital payment technologies and peer-to-peer business models. Section V is a short conclusion.

## 2. Background

The roots of the modern microcredit industry lie in Bangladesh and specifically with regard to the work of the United States trained Bangladeshi economist, Dr. Muhammad Yunus. Following his analysis of a number of microcredit programmes already underway in what was then East Pakistan, particularly the ‘Comilla Model’ pioneered by Akhtar Hameed Khan (see Raper, 1970), Yunus began his own experiments with microcredit in the village of Jobra near Chittagong. Very soon Yunus claimed that with his own version of microcredit, which involved a novel form of ‘social collateral’<sup>3</sup>, even the very poorest could successfully engage in tiny entrepreneurial activities and, in so doing, could successfully repay their microloans. That is, the poor were now said to be “bankable”. Yunus’s central message to the international development community was that, with the help of microcredit, it was now possible to “bring capitalism down to the poor”. This was a very enticing message indeed and it soon precipitated the arrival of a large amount of financial support in order for Yunus to operationalize his own ideas for a “bank for the poor”. This financial support gave birth to the now iconic Grameen Bank, as well as a growing number of other microcredit institutions (hereafter MCIs) in Bangladesh, and then right across Asia. The international donor community was now fully convinced that the microcredit model could make major inroads into global poverty and, importantly, in an acceptable individualistic, private sector-led, and market-affirming manner. With growing international donor support, the global microcredit industry was born.

But even as the microcredit model began to be adopted all around the global south in the 1980s, the more neoliberal-oriented institutions within the international development community, notably the United States of America Government's aid assistance arm, USAID, and the World Bank, found what they thought to be a fundamental operational flaw. This was the fact that most of the world's MCIs at the time, very much including the Grameen Bank itself, funded their operations with a variety of subsidies provided by the international donor community, host governments, and private foundations. With the idea of subsidies anathema within the international development community from the 1980s onwards, the original subsidy-dependent Grameen Bank-style microcredit model simply had to be abandoned. In its place came a new highly commercialized business model that prioritized the profitability and financial self-sufficiency ("full cost recovery") of the MCI (CGAP, 1995; Robinson, 2001).<sup>4</sup> In addition, the international development community began to mount a major effort to deregulate the microcredit industry, seeing this move as the best way to provide sufficient freedom for the now for-profit microcredit industry to get on with the business of providing as much microcredit to the poor as possible. Many in the international development community and elsewhere were soon convinced that the new commercialized microcredit model was going to usher in a "new world" of massive poverty reduction and human progress (Otero and Rhyne, 1994). Financial resources, technical support and political backing now began to shift even faster into expanding the microcredit industry, including by scaling back other interventions with broadly similar local economic development goals, such as support for SME financing programmes.

The building excitement in the international development community was quickly reflected in the increasingly voluminous academic literature purporting to confirm the basic microcredit model's supposed poverty reduction achievements in developing countries – see for example, Yunus, 1989; Servon, 1997; Remenyi and Quiñones, 2000; Wright, 2000; Robinson, 2001; Copestake et al., 2005; Dowla and Barua, 2006. Numerous impact evaluations produced in the 1990s and early 2000s by academics and international development agency analysts also appeared to confirm the view that microcredit worked as its pioneering proponents claimed that it did (see the summary of the most important of these evaluations by Odell, 2010). Importantly, then World Bank economists Mark Pitt and Shahidur Khandker (1998) also appeared to provide some very robust evidence of positive impact, a claim that many microcredit advocates, above all Muhammad Yunus himself,<sup>5</sup> began to deploy in order to justify the microcredit model to the world.

By the mid-2000s, the celebration of the microcredit model reached a crescendo. The United Nations designated 2005 as the "UN Year of Microcredit", which was followed by

the announcement that Muhammad Yunus and the Grameen Bank he founded in 1983 were to be the co-recipients of the 2006 Nobel Peace Prize. The ILO's then head of social finance, Bernd Balkenhol, essentially spoke on behalf of the international development community when at the high-profile 2006 Microcredit Summit he proclaimed that microcredit was “the strategy for poverty reduction *par excellence*” (Balkenhol 2006, underlining in the original).

And then the consensus around the microcredit model began to fall apart very quickly indeed and the microcredit model began a rapid descent into near-collapse.

The exact time when this reversal of fortunes began can actually be pinpointed quite precisely, to April 2007. This was when Mexico's largest microcredit bank, Banco Compartamos, underwent an Initial Public Offering (IPO) of its shares. What was so important about this IPO was not that it demonstrated to the world that poor Mexican communities were escaping their endemic poverty – there was then, and still remains today, no evidence whatsoever for this - but that Banco Compartamos's senior management and major investors had managed to engineer for themselves quite spectacular financial windfalls. With ultra-high interest rates, always above 100 per cent and touching as much as 195 per cent on some microloan products, the enrichment of a narrow elite appeared to have been facilitated by egregiously over-charging the very poorest in Mexico, particularly women (Bateman, 2010: 142-152; Butcher and Galbraith, 2015). The Banco Compartamos IPO sent out the unmistakable signal to the financial world that microcredit represented an almost unrivalled instrument with which spectacular private capital accumulation could be secured *at the direct expense of the poor*. The parallel with the rapid growth of hugely profitable sub-prime lending activity in the United States of America before the crash of 2008 should be readily apparent.<sup>6</sup>

The extreme unease created by the Banco Compartamos IPO opened the floodgates to a wave of enquiry as to the microcredit model's real, as opposed to merely implied or assumed, impact upon poverty and development. While a fairly popular subject in anthropology, sociology and political theory (e.g., Fernando, 2006), a steadily growing number of development economists began to mount a challenge to the conventional wisdom and explore the downsides to microcredit. Major journals and academic publishers previously rejecting out of hand any submission or book proposal critical of microcredit began to open up to limited criticism of the microcredit model, and then full blown rejection. New supposedly more accurate evaluation mechanisms (notably the Randomised Control Trial [RCT] methodology) also began to be deployed more widely. Pretty soon the entire evidence base purporting to demonstrate a positive impact from microcredit began to collapse.



### 3. Microcredit As Anti-Development Policy

Summing up the results of the post-2007 re-evaluation of the evidence supporting microcredit, there are at least five major inter-related issues that have essentially destroyed the microcredit model's validity as a poverty reduction and local economic development intervention.

#### A. No evidence of net short-term poverty reduction

From the 1980s onwards, a large number of impact evaluations and case studies have been produced that appear to support the case in favour of microcredit, particularly through the additional jobs and increased average incomes route. However, much of this evidence was seriously, and often deliberately, flawed. In particular, a major source of bias arose in the very many studies adopting the “treatment versus control groups” methodology to measure impact (a typical example is Wydick, 2002). This approach produced false positive conclusions because it failed to factor in important negative externality impacts that act to depress the level of net additional jobs and income benefits in the community being otherwise reported as generated with the help of microcredit (see below). While some economists acknowledged that these important externality problems existed when referring to the lack of real evidence confirming the positive impact of microcredit (Armendariz de Aghion and Morduch, 2005), nevertheless the standard evaluation methodology went unchanged for quite some time. The conventional wisdom that “microcredit works” thus persisted also.

After 2007, however, the conventional wisdom began to come under very serious review. This began with some tentative admissions from long-running advocates that the impact of microcredit had been seriously over-stated and major changes were needed to “bring development back into the picture” (Fisher and Sriram, 2002; Dichter and Harper, 2007). Other development economists then began to weigh in with the argument that the accumulated evidence actually showed that microcredit was not just seriously under-performing, as advocates were now coming around to accepting, but was actually undermining and destroying the local economy's chances of development and growth, and so also poverty reduction (Bateman, 2003, 2010a; Chang, 2010; Bateman and Chang, 2012). This negative view of the impact of microcredit was then followed, and effectively confirmed, by important reviews of the existing evidence contracted out to independent economists and evaluation experts. Of particular importance here were the results of Duvendack et al.'s (2011) United Kingdom Government-funded systematic review of virtually all the impact evaluation evidence to date. Reviewing 2,643 impact evaluations of microcredit, the evaluation team found that only 58 were robust enough,

on the basis of research design and methods of analysis, to study further. But even when looking deeper into these 58 supposedly more scientific impact evaluations it was still not possible to confirm a positive impact from microcredit. The deeply unsettling conclusion the evaluation team came to was that “(the) current enthusiasm (for microfinance) is built on (...) foundations of sand”, and they very pointedly enjoined the academic community to undertake further research in order to understand “[why] inappropriate optimism towards microfinance became so widespread” (*ibid.*: 76).

Pitt and Khandker’s (1998) hugely influential study, mentioned above, then also came under renewed examination. The result was that many of its most central claims were over-turned by Duvendack and Palmer-Jones (2012) and Roodman and Morduch (2013) as they attempted – unsuccessfully – to replicate its positive results.<sup>7</sup> By 2014, the results of a number of Randomised Control Trial (RCT)-based impact evaluations of microcredit also began to come through and they found very little positive to report. Summing up the results of six major RCT-based impact evaluation studies, Banerjee et al. (2015: 13) found that microcredit had very little positive impact on the ground, concluding that, “The studies do not find clear evidence, *or even much in the way of suggestive evidence*, of reductions in poverty or substantial improvements in living standards. Nor is there robust evidence of improvements in social indicators” (my italics added). It is also telling, as I note elsewhere (see Bateman, 2013a), that many of the most important downsides to microcredit reported by Banerjee et al, such as externalities and “crowding out” effects, were *still* not factored into these latest RCT studies. This clearly helped to skew the results in favour of there being more of a positive impact (or less of a negative impact) than the data they used actually pointed to. It was thus effectively confirmed by the mid-2010s that the microcredit model had had no meaningful net impact on poverty, or on any other indicator of an advance in human welfare (e.g., sustainable jobs, local economic growth, gender empowerment, reduced vulnerability, greater security). Many long-time academic supporters of microcredit were now forced into making a full retreat (for example, see Altman, 2014).

One of the major reasons why the basic microcredit model has had no net positive impact on poverty is that, in a nutshell, it is a fundamentally flawed intervention. It was centrally based on the heroic assumption that all of those poor individuals accessing a microcredit to get into informal business activities would *never* encounter a local demand barrier. A poor individual could establish an informal microenterprise in her own village or community and then, at a price sufficient to cover both costs and to register a surplus, it was simply assumed that she would always be able to sell virtually any amount of basic goods and services to her equally poor neighbors. As Muhammad Yunus (1989: 156) famously declared early on,

*“a Grameen-type credit programme opens up the door for limitless self-employment, and it can effectively do it in a pocket of poverty amidst prosperity, or in a massive poverty situation” (my italics).*

This fundamental assumption is, of course, quite wrong. Muhammad Yunus, had actually fallen for one of the most famous fallacies in economics - Say's Law, the mistaken idea that supply creates its own demand. As Amsden (2010) pointed out, poverty in the global south in recent times has *not* arisen because of an insufficient supply of the basic goods and services needed by the poor to survive, which might possibly justify the role of the microcredit model in increasing this supply: poverty has arisen much more because of the lack of purchasing power (effective demand) that is necessary for the poor to obtain these important things. As many development economists, anthropologists and political theorists have reported for many years (for example, Breman, 2003; Davis 2006; Standing, 2010) in conditions of unchanged local demand (even worse consequences are forthcoming under austerity and fiscal restraint), a programmed increase in the size of the informal sector (i.e., in the supply of the simple products and services provided by informal microenterprises and self-employment ventures), predictably forces the global poor further into a “race-to-the-bottom” where incomes are increasingly competed down to the bare subsistence level.<sup>8</sup> Also intrinsic to the “race to the bottom” model is heightened exploitation and inequality, worsening working conditions, fewer public services and rising levels of violence and business “turf wars” in the community.

One important aspect involved in the “race to the bottom” can be unpacked in a little more detail. As Nightingale and Coad (2014) demonstrate, sustainable job creation in the global south encounters certain fundamental barriers. The first of these is that high levels of new microenterprise entry in poor communities are generally always followed by high levels of job displacement, which is where a broadly comparable number of the existing jobs in incumbent microenterprises are lost following the entry of new microenterprises. In Africa, for example, this adverse dynamic is a major problem and it clearly helps to explain why very high rates of entry have not translated into as high a number of sustainable jobs in the community as suggested by the raw entry figures (Page and Söderbom 2012). Secondly, there is the related problem of exit, where both new and incumbent microenterprises are eventually forced to close down due to the increased competition and reduction in average microenterprise turnover inevitably precipitated by the inflow of new entrant microenterprises. Exit rates right across the global south, again especially in Africa (Patton, 2016), are typically very high indeed.

This combination of high levels of displacement and exit is known as “job churn”, and the upshot is that it results in far fewer sustainable local employment opportunities being realized through informal microenterprises and self-employment ventures than

the typically highly publicized entry figures would suggest. In addition, it is almost inevitable that the increased competition stimulated by new entry will lead to a decline in average incomes across the wider informal sector.<sup>9</sup> In some cases, the benefit of some employment gains in the informal sector is entirely cancelled out by the dis-benefit represented by a *very* steep decline in average incomes, such as in post-apartheid South Africa.<sup>10</sup>

## **B. The microcredit industry actually undermines growth and development**

The original claims made on behalf of the microcredit model centred on poverty reduction achieved because poor clients would have access to a cheaper form of credit than that provided by the traditional moneylender, thus rendering tiny informal enterprises at least a little more profitable than before (Yunus, 1989). As the movement began to gather pace, however, a more far-reaching theory of local economic development incorporating microcredit began to emerge. This new theory focused upon the many informal microenterprises getting established, learning, agglomerating, eventually converting into formality, and then the best of them growing into small and medium sized enterprises. Influential “trouble-shooting” economist, Jeffrey Sachs (2005) is one of the highest-profile proponents of the view that microcredit can help the global poor climb what he calls the “ladder of development”, going from a new informal microenterprise to a small formal enterprise with some employees, and maybe even going further to become a medium- sized enterprise. The poor would thereby escape their own poverty but also, through investing locally, hiring new employees, adopting important technologies, and innovating products and processes, would promote the economic development of the community as well.

In practice, however, there is no discernable link between the promotion of the informal sector through microcredit and sustainable local economic development and growth. In fact, the evidence tends to run in the opposite direction; that the microcredit industry undermines and frustrates the goal of sustainable local economic development and growth. Several reasons account for this.

First of all, there is no real evidence to substantiate the long-standing “common sense” idea that the informal microenterprise sector serves as the foundation, or “breeding ground”, for the much more productive formal SMEs that are required. This notion has been comprehensively disproved by such as La Porta and Shliefer, (2008) and Shane (2009), who point out that all but a very tiny number of formal SMEs begin their life-cycle as a formal SME. Informal microenterprises and self-employment ventures overwhelmingly remain small and unproductive, or else they exit very quickly. The inability to reap standard scale economies here is important. Particularly because the

informal sector very much involves the petty retailing sector – “mom and pop stores” dominate the informal microenterprise sector everywhere in the global south – the loss of potential productivity gains thanks to the inability to reap scale economies is likely to be very significant indeed (on the importance of the retail sector in raising productivity, see Lewis, 2004). The spread of informal petty retail outlets is also a “quick return” activity, but it all too often embeds a negative “learning to trade rather than learning to produce” dynamic within the local economy.

Second, informal microenterprises also hinder important technology transfer and industrial upgrading processes. For example, large numbers of tiny retail or production outlets each with very little turnover most often do not find it practically feasible to begin to mechanize, which greatly raises productivity, whereas a smaller number of larger units with higher turnover do. Nor are informal microenterprises capable of establishing crucial productivity-enhancing connections to other enterprises, such as through sub-contracting, clustering, networking and supply chain participation. And many of the vertical connections that *are* forged involving informal microenterprises actually exacerbate poverty and under-development. This happens when, in order to reduce their own costs, large local or foreign companies decide to abandon working with traditional unionized formal SMEs paying decent wages and adopting some technology, and redirect their sourcing to the non-unionized, low-wage, no technology informal sector (Carr and Chen, 2002). Often-times this adverse trajectory has been directly aided by the international development community itself as part of its assistance to developing countries. This happens, for example, when large companies in the developed countries are assisted to identify new lower cost supply chain arrangements in developing countries under cover of “creating local employment”, but which simply displace existing formal suppliers paying decent wages in order to replace them with new informalized suppliers supported with microcredit that minimally reward any employees. Overall, this supply chain development trajectory is well known as one of the principal factors that leads not just to much lower incomes and precarious employment in the global south (Standing, 2010), but to a wider “dumbing down” of the local economy and the gradual reduction in its resilience, technological sophistication and capacity to function.

A third important drawback to the microcredit model arises in the product market, and, importantly, one that functions at whatever level of funding is intermediated into the informal microenterprise sector. Very often even the most productive formal SMEs and larger enterprises find it hard over the short term to compete with informal microenterprises that do not pay decent wages, do not allow trade unions, do not pay

local or national taxes, do not respect environmental legislation, and so on. Market share lost to the informal sector (even if only temporarily) thus immediately raises the formal sector's costs, as well as into the longer run creating market instability and frustrating the potential for business planning, which in turn inevitably deter the level of long-term investment and potential for organic growth (Farrell, 2004). In other words, not because of positive competitiveness factors, but because of negative informality factors, the informal sector can very damagingly undermine and even displace the far more productive formal sector.

One important example of this problem is worth exploring in a little more detail because it involves the case of Bolivia, one of the world's most developed and supposedly more pro-development microcredit sectors. Here research by Vargas (2012: 23) finds that informal microenterprises have seriously undermined the sustainable development of the local formal economy (see also Velazco-Reckling, 2015). This is because formal SMEs in Bolivia are increasingly being outcompeted by growing numbers of unproductive informal microenterprises that can survive for a short time by pricing very low. They can do this because they pay ultra-low wages, provide poor working conditions, do not respect health and safety regulations, and avoid most local tax responsibilities. Under such unfair conditions, the most productive formal enterprises thus find it immensely difficult to maintain market share, which makes it much harder to forward plan and invest, adopt important technologies, train workers, and so on. Growth of the formal sector in Bolivia is thus stunted by the microcredit-induced support for the informal sector.

Moreover, greatly compounding this product market competition problem is a financial market problem, one that is impacting negatively in Bolivia just as much as it is impacting negatively right across Latin America of late (Pagés, 2010; Bateman, 2013b). From almost nothing in the 1980s, the proportion of Bolivia's scarce financial resources intermediated into supporting informal microenterprises and self-employment ventures had by 2012 risen to as much as 37 per cent of this total (Vogel, 2012). However, the resources to allow this expansion of the microcredit sector are often mobilized by gradually contracting the level of lending to formal SMEs. This means that formal SMEs cannot easily invest their way to higher productivity, which might eventually lower their prices and thus allow them to compete with the informal sector. Thus, at a time when the informal sector is being pushed harder than ever by local MCIs to take on more microcredit, and so over-indebtedness is rising once again to worrying new heights (Gonzalez and Javoy, 2012), the formal SME sector in Bolivia is being increasingly “crowded out” of financial support on affordable terms and maturities.<sup>11</sup>

In sum, we find that in all of those developing countries wherein the microcredit model has penetrated the most, we also find significant impetus created towards the informalization, primitization and de-industrialization of the local economy (Bateman, 2010a; Bateman and Chang, 2012). This suggests that the more microcredit is made available in a country, the less likely than ever that it will be able to create the local conditions required to “catch up” with developing countries. Even worse, the increased profitability of microcredit has led many financial institutions to move to supply informal microenterprises and self-employment ventures with more microcredit than they can hope to cope with, while moving out of other less profitable, but potentially more productive fields (termed “downscaling”), such as supporting formal technology-based SMEs. This has resulted in a financial sector “crowding out” effect that has had a quite devastating impact on productivity (for the example of Latin America, see Pagés, 2010; Bateman, 2013b).

A formal explanation for the adverse development trajectory catalyzed into existence by the microcredit industry can be gleaned from the important work of the development economist and economic historian Erik Reinert (2007). His overall argument is that the programmed expansion of small-scale, ultra-low productivity and diminishing returns activities, most often taking the form of informal microenterprises, self-employment ventures and subsistence farming, will greatly undermine the local economy. This is because important scale economies are lost, technologies suitable at certain volumes of activity are abandoned, and important efficiency-enhancing vertical and horizontal inter-enterprise connections are inoperable. The problem (*ibid.*: 171) is that,

*“Systems based on increasing returns, synergies and systematic effects all require a critical mass; the need for scale and volume creates a ‘minimum efficient size’. When the process of expansion is put in reverse and the necessary mass and scale disappears the system will collapse.”*

Importantly, the general retrogression process described by Reinert is *exactly* what we are seeing across the global south in all of those locations – national, regional and local – where the microcredit model has gained the strongest foothold.

In a very real sense, following Reinert, we might say that the basic microcredit model is akin to a modified form of the Morgenthau Plan, the “anti-development” plan formulated during World War Two in order to permanently emasculate the post-war German economy and reduce it to such a primitive status that the country would be incapable of waging war ever again (Reinert, 2007: 179–184). The Morgenthau Plan was based on funding only the most primitive of small enterprises and agricultural operations, combined with a ban on industrial research.<sup>12</sup> Similarly, rather than actively shepherding

scarce financial resources into promoting bottom-up development through support for formal enterprises with the most potential to scale-up, deploy some forms of technology, develop innovative products or processes, and thus reap productivity gains, the microcredit model propels the local economy in completely the other direction: that is, it shifts financial and other resources into the very simplest of economic activities that in combination contribute towards *further* de-industrializing, primitivizing, informalizing and disconnecting the local enterprise structures. This programmatic expansion of informal microenterprises, self-employment ventures and subsistence farming effectively helps to permanently “lock-in” a state of under-development and poverty. The microcredit model as it has been operating in the global south can thus be seen as a Morgenthau Plan-style “anti-development” plan that is being carried out for real.

### **C. Microcredit inevitably leads to over-indebtedness and regular “microcredit meltdowns”**

The microcredit model was originally pitched by Muhammad Yunus and others as a way of marginalizing the traditional money-lender, or loan shark, in the global south. By providing a lower cost and less risky credit alternative for the poor, it was argued that the microcredit model would allow them more chance to be successful in their informal income-generating projects. However, one of the most important outcomes of the microcredit model is that in almost all of those locations where it has been most successful in its aim of gaining a significant foothold in the local financial system, it has gone on to precipitate dangerous levels of individual over-indebtedness and increased individual vulnerability (Bateman, 2010a: 140–141; Guérin et al., 2013; Guérin et al., 2015). Guérin and Servet (2015) patiently document the growing number of developing countries that are buckling under the pressure of trying to absorb a flood of microcredit when all the signs are that the population is already massively over-indebted.<sup>13</sup>

The inevitable end result of this rising over-indebtedness trajectory is a growing number of destructive sub-prime-style “microcredit meltdowns” in all of those countries initially held up as “role models”. Beginning with Bolivia in 1999, a hugely destructive event that was passed off by microcredit supporters as a “one-off” event (see Rhyne, 2001), a series of meltdowns then followed from 2008 onwards in Nicaragua, Morocco and Pakistan (Schicks and Rosenberg, 2011). Bosnia’s astonishing rise to become the world’s second most microcredit penetrated country by 2008 was the precursor to a hugely damaging meltdown beginning soon after, which compounded a range of other seriously deleterious impacts attributable to the microcredit model (Bateman, Sinković, and Škare, 2012). In 2010, the most destructive meltdown to date took place in Andhra Pradesh State in India. Driven forward by the reckless lending strategies of the CEOs



of the “big six” MCIs, for a time this one state was the most microcredit saturated location on the planet, but then the bubble was popped and in less than a year its vastly over-blown microcredit sector was reduced to almost nothing.<sup>14</sup> Cambodia possesses one of the world’s fastest growing and most profitable microcredit sectors, and a meltdown has long been predicted as a result of the microcredit sector’s seemingly infinite expansion plans. Finally, in 2016 the Cambodian government took concrete steps to avert the approaching calamity, which it felt had the potential to bring down the entire financial system (Bateman, 2017, forthcoming). At the time of writing (October 2017) it remains to be seen if these recent moves to curtail the expansion plans of the largest MCIs will be sufficient, though they do appear to have slowed the upward growth curve somewhat. A number of other developing countries have for a while been teetering on verge of a major ‘microcredit meltdown’, headed up by Mexico (Rozas, 2015) and Peru (Sinclair, 2014). Moreover, it cannot be over-emphasized that in none of these country examples do we find any solid evidence that poverty has been meaningfully reduced as a result of the explosive expansion in the supply of microcredit (for example, see Bateman, Blankenburg and Kozul-Wright, forthcoming).

One important explanation for the continuing crises in the global microcredit sector is derived from the work of Hyman Minsky. Minsky’s (1986) “financial instability” theory of financial markets under deregulated capitalism is now seen in retrospect as an accurate explanation of the extreme over-indebtedness underlying the global financial crisis that erupted in 2008 (Galbraith, 2014; Wray, 2016). Minsky’s analysis of the stages of fragility in the lending process in capitalist finance also provides a very useful analytical tool with regard to helping explain the growing global phenomenon of over-indebtedness and crisis associated with the deregulated microcredit sector. It very usefully explains why the microcredit sector is *structurally predetermined* to experience rising over-indebtedness and repeated crisis, precisely because it is based upon a combination of, (a) commercialized profit-seeking MCIs possessing a willingness to compete and self-interestedly expand beyond the actual absorptive capacity of the local economy, and (b) a lack of regulation (i.e., self-regulation), de-supervision and other liberalizing measures insisted upon by the international development community that encourage and permit MCIs to engage in such destructive behaviour.

In two senses, in fact, we find that the microcredit sector is often fated to enter into the range of adverse market dynamics predicted by Minsky. First, many MCIs all too often engage in lending to clients right up to the point where they are forced to enter the Ponzi stage of borrowing, which is where clients can only cover their repayments by constantly rolling over their microloan, borrowing more or selling assets. Second, many

MCI themselves also seem unable to avoid entering the Ponzi stage. This happens when an MCI takes on commercial loans for on-lending to individual clients but then, thanks to high default rates and other problems encountered, the MCI finds it can only finance the repayments on this commercial loan by constantly rolling-over its own debt, borrowing more, or selling assets (for example, via the securitization of loan books). Either way, such Minskyian instability in, and created by, the gradual evolution of the global microcredit sector has become a very serious problem.

#### **D. Rise of extreme profiteering and unethical behaviour**

The commercialization of the microcredit model pushed through in the 1990s was premised on the understanding that the newly commercialized microcredit industry would continue to responsibly lend to the global poor. This hope has turned out to be a forlorn one. Instead, commercialization almost immediately created a wave of Wall Street-style “blowback” outcomes linked to profiteering and fraud. As noted above, the Initial Public Offering (IPO) of Banco Compartmos in Mexico in 2007 stands as the defining moment when it was first realised that the microcredit industry could be captured by a narrow financial elite and, in a very real sense, turned into an intervention designed to serve their private enrichment objectives at the expense of the interests of the poor. Similar private enrichment episodes very quickly began to emerge as the norm all over the global south (Bateman, 2010a; Sinclair, 2012). This effectively confirmed that the microcredit model had not just become just another business, but had been very thoroughly “Wall Street-ized” and it was now producing predictable Wall Street-style results.

By the early to mid-2010s, many microcredit supporters began to lament that the social mission of the microcredit industry had been completely subverted. Notably these disaffected individuals included one-time leading proponents of the microcredit model Malcolm Harper (2011) and Chuck Waterfield (2016) (see also Sinclair, 2012). To all intents and purposes, they felt, the global microcredit industry had been taken over by opportunistic individuals, greedy entrepreneurs, aggressive private banks, and hard-nosed investors, and the original purpose has been lost in the search for profit and reward for those closest to the MCI. The very largest MCIs are virtually all now aggressive profit-seeking businesses not unlike the commercial institutions and money-lenders they originally hoped to replace. There has been much exposure of stratospheric private enrichment, extremely risky behaviour, and unethical and often illegal actions in so many of the leading MCIs, in the microcredit advisory and consulting community, and in the leading global investment institutions that have invested in the microcredit sector (hedge funds, commercial banks, Microfinance Investment Vehicles [MIVs], pension funds, etc).

Even the CEOs of the largest global microcredit advocacy and investment bodies now demand to be rewarded with Wall Street-style salaries and bonus packages.<sup>15</sup>

Such private enrichment clearly does not fit well with the microcredit industry's self-declared "concern for the poor". The global microcredit industry has thus very much emulated, rather than stood apart from, the global "financialization"-driven unethical behaviour, fraud and corruption that has taken over the global financial sector since the early 1980s (Galbraith, 2014; Whyte and Wiegatz, 2016).<sup>16</sup> The inevitable result is that the global poor are no longer the primary beneficiaries of the commercialized microcredit sector, but increasingly nothing more than its hapless victims.

Drilling down even further, in very many respects one can argue that the deregulated and profit-driven global microcredit industry has been overwhelmed by a wave of what Black (2005) has termed "control fraud" – a fraud committed against an organization and its clients, employees and shareholders by its CEO and other senior management.<sup>17</sup> Thanks to the turn to neoliberalism in the 1980s such forms of control fraud have become epidemic, and, especially in the United States corporate sector, in a very real sense incorporated into regular business practice.<sup>18</sup> In this new "financialization" era, the CEOs and senior management of many MCIs are increasingly incentivized, because of permissive attitudes to greed and wealth, and able, because of deregulation and de-supervision, to become control frauds. Microcredit control frauds thus seek to exercise full control over their own MCI not so much in order to promote poverty reduction, but to recklessly expand the MCI as rapidly as possible in order to quietly and quickly maximize their own short-term rewards, taken out as high salaries, bonuses, interest free loans, large pension pot payments, share options, private business activities funded and promoted by the MCI, and so on.

In the worst possible cases, CEO have been willing to adopt a reckless lending policy as part of a concerted push for personal enrichment even though this means the almost certain destruction of the MCI in the longer-run.<sup>19</sup> The number of cases of microcredit control fraud leading to reckless lending and dangerous over-expansion, and then actual or near bankruptcy, has very much increased in recent years.<sup>20</sup> Indeed, virtually all of the most high-profile and universally respected MCIs can be included in this group of control frauds, starting in Bangladesh with the Grameen Bank, BRAC, ASA (Chen and Rutherford, 2013), the 'big six' MCIs in Andhra Pradesh State in India (Arunachalam, 2011), the largest MCIs in Bosnia and Herzegovina including Mikrofin, Lok, Synergija, PRIZMA (Bateman, Sinković and Škare, 2012; Black, 2012), South Africa's largest MCIs Saambou, Unifer, Capitec and African Bank (Bateman, 2015), Nigeria's LAPO (Sinclair, 2012), and many MCIs in Latin America alongside Banco Compartamos (Butcher and Galbraith, 2015).

## **E. Accumulation by dispossession**

One of the central initial claims for the microcredit model was that it would lead to much-needed capital flowing from the rich northern countries to the poor global south (Ashta, 2007). This predicted flow was explained by neoclassical economic theory on the basis that where capital is scarce, the returns will be higher. This movement of capital should in theory raise productivity by, among other things, helping to establish new and expand existing informal microenterprises, which were automatically assumed to be productivity-raising. Such a movement would also contribute towards increasing the level of local demand, which would help underpin the additional microcredit-induced output of simple products and services thereby realized.

This capital flow may well have been in existence in the early stages of the microcredit industry in the 1980s when the international development community was capitalizing a raft of non-profit MCIs. However, as the global microcredit sector has increasingly commercialized, this flow of funds has reversed itself in a very big way. Mader (2015: 118) has estimated that as much as US\$125 billion has been taken out of the global south since 1995 thanks to the collective repayment of interest on microloans that, on average (as noted above), do not actually reduce poverty. In a sense, MCIs regard the earnings of informal microenterprises as a flow of funds that can be used to repay high interest rate microloans, thus allowing the MCI to capture a large part of the economic surplus of a poor community. In addition, with a growing volume of developed country FDI channeled into the microcredit sectors in the global south, significant outflows of dividends, management fees, and capital appreciation have also flowed abroad.<sup>21</sup>

While the microcredit movement may have started as an attempt to develop the global south, its evolution has been marked out by the very opposite of this: it is now a major way that global financial corporations can drain wealth and resources from the global south under cover of “promoting poverty reduction”.

## **4. Beyond Microcredit**

The central uplifting claims made from the 1980s onwards that microcredit would resolve poverty and promote local economic development are now very widely accepted as false. In fact, the global microcredit movement would appear to have set in train an “anti-development” trajectory in the global south, one that is responsible today for crushing levels of individual over-indebtedness, increasingly regular “microcredit meltdowns”, increased unethical behaviour and outright fraud, and a massive misallocation of scarce financial resources into the least productive and developmental enterprises – informal

microenterprises and self-employment ventures – and so away from the far more productive enterprises – formal SMEs – that countries in the global south desperately need in order to develop, diversify, upgrade, and ultimately reduce poverty (Bateman and Chang, 2012).

Nonetheless, the international development community appears extremely reluctant to abandon the microcredit model. Instead, a major effort has been mounted to rescue the microcredit model by incorporating it into a completely new agenda termed “financial inclusion”, defined as the drive to endow the poor in developing countries with all of the most basic financial tools – microcredit, micro-savings, bank accounts, payment cards, mobile money systems, and so on.

This effort is being undertaken, as Mader (2016) cogently argues, in spite of there being no real evidence that financial inclusion can address poverty as its advocates claim that it can. While we may accept that financial sector deepening *per se* is positively related to economic development, as King and Levine (1993) have reported, the literature that their work gave rise to largely refers only to the important rise in credit allocated to the enterprise sector *as a whole*, and not to how much the informal microenterprise and self-employment sector receives compared to formal small, medium and large enterprises. Conceivably, if financial deepening involves more financial support going into small, medium and large enterprises as opposed to informal microenterprises and self-employment ventures, as Mader goes on to speculate, then the positive poverty impact could even be interpreted the other way around entirely: financial sector deepening that involves channeling financial resources *away* from informal microenterprises and self-employment ventures and *towards* formal small, medium and large enterprises would be the optimum development strategy. And, in fact, economic history *does* show that those countries that have managed to channel their scarce financial resources into formal small, medium and large enterprises have all developed much faster, and reduced poverty much faster, than those countries where the available financial resources were channeled into informal microenterprises and self-employment venture (Bateman and Chang 2012; Chang 2010). Widespread claims that financial inclusion *causes* poverty reduction thus amount to nothing more than mere *correlation*, such as when for convenience reasons better off individuals voluntarily choose to use more financial services (credit, credit cards, etc.) as their income grows.

This pessimistic view is now very much beginning to be reflected in the data. In Kenya, for example, which is otherwise seen as a “stand-out” success story for the financial inclusion movement thanks to M-Pesa, Gibson’s (2016) study for a United Kingdom Government-funded body, FSD Kenya, found no evidence of any real poverty reduction

as a result of its now very high level of financial inclusion. Pointedly, what Gibson (*ibid.*: 7) *did* find was that “the supply-side of the finance market (in Kenya) has benefitted greatly from the last ten years. Banks’ sales have increased by 2.5 times and profits by 3.5 times, with profit margins also increased; the “inclusion years” have undoubtedly been good years for the banks.” An even more blatant case is that of South Africa, where the financial inclusion agenda has been deployed ostensibly to support the poor, in practice it has achieved nothing more than spectacularly enriching the suppliers of microcredit, while the poor recipients have been thrown into probably the world’s worst case of (micro)debt peonage (Bateman, 2015). Even worse, these adverse trends have been markedly accelerated by the growing deployment of so-called ‘fin-tech’ – financial technology that allows for individuals to gain instant access to credit, savings, insurance and many other items with the aid of digital technologies and mobile phones. But even though many technology analysts are now predicting bad things ahead as a result, notably in Africa (for example, Gordon and Lyon, 2017), the momentum behind expanding microcredit (albeit quietly within the financial inclusion paradigm) appears unstoppable.

We can determine that at least two reasons account for this extreme reluctance to abandon microcredit. First, the microcredit industry plays a major role in validating, operationalizing and extending individual entrepreneurship and self-help as a core aspect of life in the global south under global neoliberal capitalism. Capitalism is thus “brought down to the poor” in the cynical hope that they might become “card-carrying capitalists” (see Harvey, 2014: 182–198), and thus the poor are less likely to engage in collective forms of resistance to capitalism through such as leftist political parties, trade unions, peasant rebellions, religious ‘liberation theology’ movements, an active ‘developmental state’, and so on. Indeed, this ‘pacifying’ objective was the very precise aim of the US government when first giving rise to the microcredit model in the 1960s in Latin America (see Bateman, 2017b), and it has animated many other western governments, right-wing foundations and individuals ever since.

Second, the last decade or so has shown that it is perfectly possible for savvy financial entrepreneurs and established financial and digital payment institutions to realize spectacular financial rewards by working and investing in the provision and expansion of microcredit and other micro-financial services to the poor (as in Kenya – see above). Their institutional links to, and lobbying of, the international development community and key western governments inevitably mean that such a hugely profitable opportunity would inevitably be kept open no matter the (adverse) impact on the global poor.

One result of this is that, thanks to new digital technologies and internet-based payment systems (see above), the global south stands ready to be flooded with microcredit in the coming years (Klapper and Singer, 2014). Under financial inclusion, will the global south encounter even more of the deep problems we adumbrated above in section III? Or are there perhaps local alternatives to the microcredit model that are more developmental in character?

Prior to the spectacular arrival of the microcredit model in the 1980s, significant progress had already been made in identifying what combination of institutions, organizations and regulations constitute an effective, or “developmental”, local financial system. While a much lengthier publication is really needed to fully adumbrate the obvious alternatives to the microcredit model (but see Bateman, 2007, 2010a: 166–200, 2013c; Bateman and Maclean, 2017; Bateman, Blankenburg and Kozul-Wright, forthcoming; Marois, 2013, 2017), this section briefly introduces a number of local financial institutions that history shows are unequivocally associated with the achievement of sustainable and equitable local economic development. It is here where the alternatives to the microcredit model will be located.

### ***Financial co-operatives and co-operative banks***

From the mid-1800s onwards a large number of financial cooperatives and cooperative banks were established in Europe, and these institutions soon came to be associated with the achievement of patient yet sustainable and equitable local economic development. Important examples include the co-operative banks of northern Italy, which have a long and distinguished history of supporting local economic development, and which have survived turbulent global conditions far better than their investor-owned counterparts (Zamagni and Zamagni, 2010). The real strength of the financial cooperative movement was shown after 1945, however. After restructuring and re-capitalization to repair the damage inflicted on them before and during the war, the financial cooperatives went on to play a quite decisive role in rebuilding the region’s formal SME based industrial sector into perhaps the world’s leading example (Goglio and Alexopolous, 2012).

In particular, important lessons can be learned from the individual region of Emilia Romagna. This was a once poor region that began to flourish in the post-war era largely thanks to patient co-operative bank support for a manufacturing-led formal SME development trajectory. The co-operative banks usefully built upon both the region’s largely destroyed military-industrial complex, and its long experience with co-operative enterprises, in the process creating the world’s leading regional cluster of worker and other cooperatives (on this, see Bateman, 2007: 39–42).

Germany’s form of co-operative banking eventually became a bulwark in helping establish and sustain Germany’s small enterprises, especially the famous “Mittelstand”

(medium-sized enterprises) that rose to power in the era of the former West Germany (Harm, 1992). Also efficiently serving the SME sector at the local level in post-war West Germany were the co-operatively owned savings banks (“Sparkasse”), which, likewise, proved to be very successful – *too* successful for some<sup>22</sup> - in promoting a bottom-up industrial development trajectory based on small quality-based, technologically savvy and innovative enterprises (Hakenes et al., 2014).

Spain also provides a number of important examples where co-operative based local financial systems have produced sustainable local economic development. The first one is that of the famous Mondragon Cooperative Complex (MCC) located in the Basque region of northern Spain. The Caja Laboral Popular (CLP) working within the MCC has proved over 50 or more years to be a very successful promoter of manufacturing based cooperative (Bateman, Girard and McIntyre, 2006). Such is its diligence, as well as the quality of its technical support, worker training and business planning, that the CLP has only ever had to deal with a handful of failed co-operative enterprises in its entire existence. As one long-time observer concluded (Ellerman, 1982), the CLP’s patient loans and associated financial support measures effectively laid the basis for an entire regional economy based on cooperative SME’s specializing in fairly high-end manufacturing and innovation.

The other less recognised example from Spain is Cajamar. Located in Almeria Province in the south of Spain, Cajamar, is today the largest cooperative bank in Spain. Its importance is that it served as the core driving force behind a sustainable local economic development success story that, very much like in the Basque country, turned Spain’s poorest region into one of Spain’s (and Europe’s) richest and most productive regions. The “Almeria Model” that has been carefully distilled from this experience is based on Cajamar’s self-appointed active role in local economic and community development (felt necessary since most local government capacity was destroyed by the civil war) and, in particular, its patient support for clusters of agro-industrial SMEs serving an increasingly intensive agricultural sector. In addition, as Cajamar’s own capacity developed, it was able to become a constant source of further social innovation, technology acquisition and transfer, and other forms of social and economic development. Giagnocavo et al. (2012) conclude their summary of Cajamar’s contribution as one where “a cooperative bank, in concert with the cooperative movement, was able to construct an economically stable community through sustainable innovation”.

### ***Local state owned and directed financial institutions and development banks***

Many countries in post-war Europe also owe their economic success to a variety of local state co-ordinated financial institutions. These institutions were established with the specific intention that they would underpin newly formulated local industrial policies that were being pushed through by elected local and regional governments. In post-war



West Germany, this meant the Landesbanken, or regional banks, which were jointly owned by the savings banks (“Sparkasse”) and served as their central clearing institution, and the respective regional governments (“Länder”). They were particularly important in providing low-cost funds to help the “Mittelstand” (medium sized enterprises) get back on their feet, and also larger enterprises based in their territorial jurisdiction. In Northern Italy, this meant the state owned and locally/regionally managed Special Credit Institutes (SCIs) that, as Weiss (1988) carefully documents, very successfully provided large quantities of affordable financial support (ten year loans at low interest rates) for machinery purchase and workshop modernization.

Outside of Europe, we find that as regards post-war Japan, Friedman (1988) was able to show that the local state was heavily involved in establishing networks of municipal banks and special funds attached to local governments. These local financial institutions were to prove decisive in supporting networks of highly efficient and technologically adept microenterprises and SMEs capable of inclusion in the famously efficient supplier networks built up around Japan’s largest industrial companies. And in the United States of America, the country’s most successful regional development bank - the Bank of North Dakota – happens to be a regional state owned bank. Formed in 1919 to free the local population from the clutches of the big private banks in New York and Chicago that were charging high interest rates on farm loans, the Bank of North Dakota has since then been a major supporter of local businesses and family farms. In addition, it not only prospered without the need for Wall Street-style salaries and bonuses, it survived the global financial crisis without the need for any state bailout, and it also continued in its role as a major contributor (through taxes) to the state’s budget.<sup>23</sup>

As Amsden (2001) and Chang (2006) carefully document, East Asia’s rise to dominance from the 1960s onwards is very much attributable to a range of sophisticated financial intermediation policies, especially involving national and local state development banks. In the immediate post-war period, the South Korean State first ensured that long-standing farmer owned credit co-operatives were thoroughly “de-landlordised”, before establishing numerous inter-linked local state funding bodies and bank type institutions capable of funding the investment needs of the rural agricultural sector. Food self-sufficiency was reached quite quickly. Meanwhile, after initially focussing its attention on growing the family-owned enterprises (“chaebols”) into export successes, in the 1970s the South Korean Government began to change course and construct a very effective industrial SME development support structure in the country. Among other things, this effort resulted in the Small and Medium Industry Promotion Corporation (SMIPC) in 1979, strengthened the already existing Korean Credit Guarantee Fund for SMEs, founded numerous State funds (grants and soft loans) to support SMEs in specific sectors

and to facilitate new entry, introduced regulations to cajole other banks and financial institutions to build up a portfolio of SME clients, and constructed a raft of Research and Development (R&D) and technology transfer/reverse engineering institutions geared up to supporting SMEs (Nugent, 2001). As Hodgkinson (2000: 14–15) pointed out, these measures were especially decisive in building quality subcontracting capacity that enabled the “chaebols” to grow rapidly and capture export markets.

Elsewhere, in Taiwan Province of China, Thailand, Malaysia and Indonesia, similar local branches of state owned development banks worked with local governments to successfully facilitate rural industrialization and also, later on, industrial SME development through manufacturing led technology-based SMEs (Wade, 1990; Lall, 1996; Meyanathan, 1994; Hutchinson, 2013).

China learned much from these successful Asian examples. It is not so well-known that China’s initial growth impetus came in the 1980s not from FDI, as is often commonly assumed, but from rafts of local government owned and industry-based Township and Village Enterprises (TVEs). Generously endowed with the latest foreign production technologies, with easy access to the entrepôt port of Hong Kong, yet all the while subject to hard budget constraints, the TVEs began to proliferate very rapidly right from the start. By the mid-1990s there were nearly 7.6 million industrial TVEs operating right across China (O’Connor, 1998), which represents probably the most successful experience of “municipal entrepreneurship” of all time. It is even less well known that the crucial financial backing for the hugely successful TVE sector largely came from rafts of urban and rural credit co-operatives (UCCs and RCCs). These were set up and largely majority controlled by local governments, but with a broad element of community ownership (Girardin and Ping, 1997). Importantly, the RCCs and UCCs were incorporated into local development plans, and so could receive additional core funding and other forms of support from local government. Local government ownership also gave local savers the confidence necessary to mobilise sufficient local savings (for example, local people knew their savings could not be transferred out of the locality and possibly wasted on supporting heavy “rustbelt” industries in the north of China).

A little later, Viet Nam closely followed China’s model and established a similar set of very sophisticated local financial institutions under local government control and oversight. This local institutional mix proved capable of successfully developing the rural agriculture base, before it then turned to very successfully supporting a rural industrialization and industrial SME development trajectory (Bateman, 2010a: 191–198). Importantly, Viet Nam successfully engaged with a version of small-scale credit that was similar, on the surface at least,<sup>24</sup> to the sort of microcredit provided elsewhere around the world.

Microloans were accessed by those families with the skills and a suitably-sized land plot (leased by the family from the state for between 50 and 100 years) in order to kick-start small-scale farming activities. The decisive factor here, however, was not so much the microloan (or even the size of the microloan); it was local government's provision of quality collective services, such as irrigation and agricultural extension services, that enabled the farming units to be in a position to quickly "scale-up" into much more productive semi-commercial family farming units (Kerbo, 2011: 145).

In Latin America from the 1950s onwards, and in spite of some obvious limitations, state bureaucracies nevertheless proved vital in providing financial support to numerous industries and smaller suppliers through its Import Substitution Industrialization (ISI) policies. Brazil's state development bank, BNDES, has almost uniquely provided the driving force behind that country's recent economic miracle. It did this by judiciously supporting key large enterprises (such as, famously the aircraft maker Embraer), but also the SME sector, both directly with affordable loans, and indirectly through the very extensive use of local content agreements attached to its large company investments.

Although routinely portrayed as a free market success, the actual roots of Chile's economic success lie in a quasi-public public banking organization, Codelco - the world's largest copper producer and one of the most profitable facilities in the world. Rather than being privatised into the hands of eager entrepreneurs in the aftermath of Chile's military coup in 1973, CODELCO was allowed to remain in state hands and it continued to channel a significant percentage of its revenues into the state budget in order to fund numerous enterprise development programmes. Many of these programmes were undertaken by powerful state-led industrial development bodies and social venture capital funds, most notably *Fundación Chile* and CORFO (*Corporación de Fomento de la Producción de Chile*). These bodies have patiently developed and financed entirely new enterprises, enterprise clusters and entire export sectors from scratch, the most famous examples being farmed salmon and soft fruits (see Kurtz 2001; Schrank and Kurtz 2005: 686–688).

Finally, taking a leaf out of Chile's book, there is the city of Medellín in Colombia which has established and financed many of its most innovative enterprises thanks to municipality ownership of a major company in the city – *Empresas Públicas de Medellín* (EPM) – which is mandated to channel 30 per cent of its net annual profit into the city administration's budget (Bateman, Duran-Ortiz and Maclean, 2011). The most recent projects funded by these earmarked funds is a major US\$250 million business incubator and technology park located next to EAFIT University and designed to tap into its expertise and skilled graduates in several new technology applications.

### ***Financing consumption spending needs – credit unions***

Credit Unions are community-based saver-owned savings and loans institutions that have the potential to answer all the consumption credit needs of the community without engaging with the microcredit sector or the local money-lender. With much success in North America and Europe, and then elsewhere around the world, the credit union model became the standard intervention when communities required a simple, safe and fair way to save and obtain modest amounts of credit. Following World War Two and the drive for decolonization, the credit union methodology was widely promoted in the global south as just such an instrument of development. But with its emphasis on cooperation, fairness and unwillingness to take risks with its member's savings, the credit union was forcibly displaced as an instrument of international development policy by the individualistic for-profit microcredit model. This development needs to be urgently reversed.

Indeed, most recently, and especially in the wake of the global financial crisis, the credit union concept is making something of a comeback. With frequent meltdowns and mass over-indebtedness caused by the microcredit model, and with major problems still at the largest private banks, it would make obvious sense to rediscover the credit union concept as the best way of supporting poor communities provide their own collectively-owned and managed small-scale credit and savings facilities.

## **5. Conclusion**

The microcredit model initially seemed to represent a major advance in the fight against global poverty, inequality, deprivation and under-development. In practice, as even noted long-time advocates now accept, the microcredit model has not achieved for the global poor what was widely predicted for it. Even worse, the evidence shows that the microcredit model has actually proved to be a major and growing barrier to poverty reduction and sustainable local economic development right across the global south. The microcredit model might even be best described as an “anti-developmental” intervention. This suggests that alternative local financial models are urgently required. I briefly outlined in section IV some of the obvious local institutional alternatives to the microcredit model, many of which are quite categorically associated in past history with instances of sustainable and equitable local economic development and poverty reduction. With many one-time advocates now openly admitting that the global neoliberal “financialization” experiment has under-performed (Ostry, Loungani and Furceri, 2016), and with others presenting a cogent argument that it is in its death throes (Jacques, 2016), it would appear that the conditions for such heterodox local financial institutions to be validated and pro-actively supported are upon us.

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## Endnotes

1. Strictly speaking, the term microcredit has been redefined as just one aspect of a wider set of interventions, including micro-savings, micro-insurance, micro-leasing, that come under the umbrella term “microfinance”. Although the two terms are still very often used interchangeably, we will stick to the term microcredit unless the context suggests otherwise.
2. David Roodman quoted in Vivian Walt, “Does Microfinancing Really Work? A New Book Says No”, *Time*, 6 January 2012. <http://content.time.com/time/world/article/0,8599,2103831,00.html> (last accessed on 20 September 2016).
3. Clients were formed into groups and each member of the group undertook to guarantee to help repay the microloan of anyone else in that group who found they were unable to repay, perhaps because their microenterprise failed.
4. In 2001, the Grameen Bank itself was converted into a for-profit business model in a process known as the “Grameen II Project” (Hulme, 2008).
5. Based on the data produced by Pitt and Khandker, Muhammad Yunus would for many years deploy a famous quote – “5% of Grameen borrowers escape poverty every year” – which was only very much later shown to have been false (see below).
6. The move into sub-prime lending in the United States of America in the 1980s was initially justified by many of the Wall Street financial institutions on the basis of their apparent concern “to help poor minorities get on the property ladder”, a claim that helped secure a favourable regulatory environment, among other things. However, as Dymski (2009) and Black (2013) point out, the move into sub-prime lending was actually undertaken in order to allow these financial institutions and other parties (e.g., mortgage brokers) to develop a new area of capital accumulation based on the exploitation of poor minorities through ultra-high cost loans, hidden fees, one-off charges, programmed foreclosures, and a variety of other unethical and fraudulent practices, all of which combined to eventually precipitate the global financial crisis that began in 2007.
7. Most notably, Roodman and Morduch (2013) found that Pitt and Khandker seriously erred by not eliminating a tiny number of obvious outliers from their large data set. By excluding just *sixteen* of the wealthiest families from the 5,218 families surveyed by Pitt and Khandker, Roodman and Morduch were able to show that *all* the supposed gains from microcredit completely disappeared.
8. As John Kenneth Galbraith (1967) famously pointed out, it is only in the world of small enterprises where we find that “pure” market competition, including completely free entry and exit, works to compete normal profits down to zero and wages down to the subsistence level. Large capitalist enterprises, on the other hand, can plan much of their demand (through advertising, public procurement, etc.), can form monopolies and cartels

to share demand, and can otherwise create a situation (at least in the short term) where their prices are not overly governed by simple market forces.

9. For example in Mexico, Bruhn (2011) found that a program to stimulate new entry (through deregulation) created a 5 per cent increase in the number of registered formal businesses, but it also led to a 3 per cent reduction in the incomes of incumbent businesses.
10. This was the case in post-apartheid South Africa, for example, where a sizeable increase in the number of informal sector microenterprises and self-employment ventures was then completely swamped by a quite astonishing collapse in the level of average incomes in the informal sector. Over the period 1997–2003 this amounted to a more than 11 per cent per year decline in self-employment incomes, with real wages in the informal sector also falling by 7.8 per cent per year (Kingdon and Knight, 2005: 3).
11. The IFC’s Enterprise Survey for 2010 ranks “access to finance” the 4<sup>th</sup> largest problem faced by managers in small, medium and large firms in Bolivia. See <http://www.enterprisesurveys.org/data/exploreconomies/2010/bolivia#finance>
12. When US government policy-makers realized that they actually needed a *successful* post-war Germany, among other things to provide a source of demand for US exports and to prevent the spread of communism across Europe, in 1947 the Morgenthau Plan was quietly abandoned and replaced by a much more pro-active development plan – the Marshall Plan – that successfully re-industrialized Western Europe (Reinert, 2007).
13. One notable example is that of South Africa where, very much thanks to its microcredit industry (Bateman, forthcoming), by 2015 it was officially the developing world’s most indebted country, with an astonishing 86 per cent of the population in debt (see also Demircuc-Kunt et al., 2015).
14. However, seemingly learning nothing from Andhra Pradesh’s devastating experience, explosive growth in the microcredit sector in Uttar Pradesh, Madhya Pradesh, Tamil Nadu, Bengal and Bihar has led analysts to predict another meltdown is just around the corner (Sriram, 2016).
15. For example, German journalist Norbert Haering (2015) revealed that the CEO of FINCA, one of the world’s largest microcredit advocacy and investment bodies was rewarded in 2014 with US\$1.4 million, representing his regular salary and a contribution into his private pension. This not insignificant amount must be generated by FINCA’s many poor clients in Africa and Asia who are routinely paying up to 200 per cent interest rates on their microloans.
16. Moreover, a surprisingly large number of commercialized MCIs continue to quietly extract financial support (equity grants and cheap capital) from the state, the international development community and elsewhere (Cull, Demircuc-Kunt and Morduch, 2016), yet the increased profits generated as a result remain to be privately appropriated.

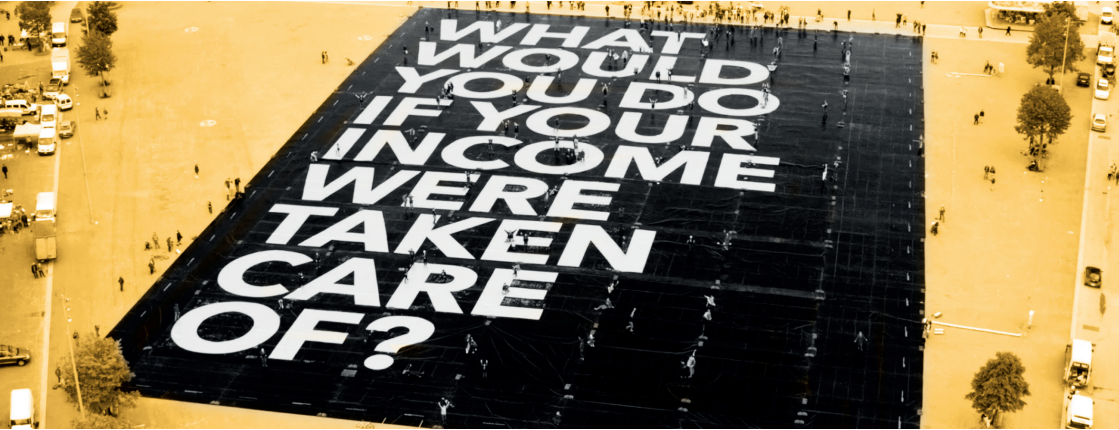


17. It is important to note that “control fraud” may be entirely legal, though, as Galbraith (2014) argues, illegality typically follows over time in most cases.
18. For example, the United States-based Wells Fargo Bank, one of the world’s largest banks, has to date been fined a total of US\$185 million because its CEO and other senior employees were found to have turned a blind eye to, if not tacitly approved of, a major exercise in fraud. This involved the opening of more than two million false new accounts for existing clients, which was done without the knowledge of clients or their consent. These new accounts thus met the aggressive performance targets set by the bank and so helped to spectacularly increase the salaries, bonuses and share option payments paid out to the CEO and other senior management (Fortune, 2016a, 2016b).
19. This trajectory was first famously highlighted by Akerlof and Romer (1994) who demonstrated that CEOs and the senior management in a financial institution operating within a weakly regulated financial system are very often willing to deliberately drive their own institution into bankruptcy if such a strategy will maximize their own individual financial returns in the interim.
20. One of the most stunning recent examples is from Bosnia involving the onetime largest and most celebrated MCI, PRIZMA. After some years of good performance and very generous salaries and bonus payments to the President and senior staff, including to the Advisory Board, the policy was changed to ‘go for broke’ in order to generate much higher financial rewards for staff. In spite of an already over-indebted client base and widespread over-indebtedness in the wider community, a policy of reckless lending was initiated by the President and meekly approved by the Advisory Board. This saw the client base almost *double* in a little over a year. As intended, the President and other senior management benefitted greatly from this turn to reckless lending. Inevitably, however, it all collapsed in 2015 when PRIZMA was forced into bankruptcy thanks to massive defaults and the running up of losses eventually totaling more than \$US40 million (see Bateman and Sinković, 2017).
21. In 2013, for example, Banco Compartamos in Mexico paid out €154 million in dividends to its mainly foreign shareholders. As Rozas (2015) remarks, this compares very well with some of the world’s largest banks - for example, Europe’s largest bank, Credit Agricole, which paid €301 million in dividend in that same year. Another example is from Cambodia. When in 2015 Jardine Matheson Holdings disposed of its shareholding in Cambodia’s largest MCI, ACLEDA, to two Japanese investment bodies it received almost \$US164 million, which represented an astonishing five-fold financial gain on its initial investment of \$US34 million in 2009 (Bateman, 2017a).
22. So successful were the savings banks (and Landesbanken – see next section) in providing low-cost patient capital to Germany’s formal SME sector that a number of SME business associations in other European countries began to lobby the European Commission to take action against the “too efficient” German local financial system, which, compared to their own market driven high-cost private banking sectors, they said unfairly advantaged German SMEs (see Bülbül et al., 2013: 6).

23. See “How the nation’s only State-owned bank became the envy of Wall Street”, *Mother Jones*, 27 March 2009). [http:// www.motherjones.com/mojo/2009/03/how-nation-s-only-state-owned-bank-became-envy-wall-street](http://www.motherjones.com/mojo/2009/03/how-nation-s-only-state-owned-bank-became-envy-wall-street) (retrieved on 29 September 2016).
24. In the context of Viet Nam these microloans should really be classed as “small enterprise loans”. Average loan size in 2004, for example, was US\$1,320, which, can be compared to the average size of a microloan in Bangladesh at that time of just US\$100 (see Bateman, 2010a: 192).



# DEVELOPMENT AND BASIC INCOME: AN EMERGING ECONOMIC MODEL



Guy Standing and  
Ian Orton

## 1. Introduction

The famous sociologist, T.H. Marshall, said in 1950 that the seventeenth century was the century of civil rights, the 18<sup>th</sup> the century of cultural rights, the 19<sup>th</sup> the century of political rights, and the 20<sup>th</sup> the century of social rights. If so, we may say that the 21<sup>st</sup> century may turn out to be the century of *economic rights*. And the most fundamental economic right is the right to basic income security, the right to have enough on which to live. And because of changes in development policy thinking and in social protection thinking, events so far are remarkably promising.

Up to the end of the 20<sup>th</sup> century, the overwhelmingly prevailing view was that direct cash payments as a development policy were marginal at best, and counter-productive at worst. What have become known as ‘cash transfer’ schemes were scarcely on the policymakers’ radar. Reviews of policies showed that while social insurance schemes were creeping into median-income and low-income countries, based on copying models developed mostly in European welfare states, there were scarcely any tax-financed non-contributory cash transfer schemes.

However, in the mid-1990s, a few were tested out, probably the most notable being the *bolsa escola* (*school grant*) city-based schemes in Brazil. By early in the new century, they were proliferating. Today, they are the new norm for fighting poverty, economic insecurity and even income inequality. It has long become clear that welfare states in rich OECD countries were failing and shrinking, and that there was very little prospect of them being replicated in developing countries.

This paper will review the evolution of cash transfer schemes, through what might be called the transitional era of so-called CCTs – Conditional Cash Transfers – through to what seems to be an emerging consensus around basic income – unconditional, universal cash transfers. We do it this way as a means of giving the paper an integrative narrative, recognising that the debates on the key design features are still unresolved and that evidence is accumulating with remarkable rapidity.

In developing countries, one reason for the sudden popularity of cash transfers, including basic income, is digitalisation and the expansion of digital payment connectivity, alongside biometric identification and authentication technology. Basically, this has transformed the state’s capacity to distribute money to people, in ways that are cheap, transparent, much less prone to corruption and leakage of funds to people who are not intended to be the recipients, and overcome the problems of remoteness and distance that typically hit the lowest-income groups.

Digitalisation has made it politically as well as economically and socially inexcusable to persist with enormously expensive fossil fuel subsidies. Iran has paved the way, and India and some other countries have been moving in the desirable direction. But still fuel subsidies are extensive, are a major cause of pollution, are deeply regressive and tend to deter fuel-saving technological change. They stand as a readily-available source of funds for cash transfers to ordinary people.

## 2. Alternative Cash Transfer schemes

Let us start with concepts and definitions. The idea behind cash transfers is simple. Instead of, or alongside, direct assistance through subsidised food, clothing and so on, the idea is that everybody should receive a regular payment in cash to help them meet their basic needs. But of course it is not as simple as that. Should only the 'poor' receive cash transfers? How much cash should be given? To whom should it be given? Should behavioural or other conditions be attached to the payment? Should they be permanent or only short-term?

These and other questions have dogged the policy debate, and it is fair to say that in many respects the scope for unresolved controversy persists. However, we will suggest that on many issues, the evidence is strong if not overwhelmingly in favour of one particular interpretation or design.

We may say that cash transfers can be either very modest, that is, designed to complement other forms of aid, or they can be intended to cover basic material needs, defined as some norm-based basket of goods and services regarded as socially acceptable subsistence. In most cases, we will be referring to the latter, unless otherwise stated.

Another distinction is between cash transfers and what might be called cash grants or *capital grants*. The latter are lump sums, as have been proposed by some advocates of what one of us has called 'coming-of-age grants', lump sums given to people on reaching adulthood. These have been proposed in the USA and some other developed market economies, but will not be discussed in the context of developing countries.

So we may define cash transfers as *regular modest* payments in cash or equivalent (such as bank transfers). But then comes another design factor. Some cash transfer schemes give to the household as a unit, usually to somebody nominated as the 'household head', which has meant usually the prime-age man.

Others have been designed deliberately to give the cash to women, and specifically those who are mothers. The standard argument for this procedure is that women

are perceived as generally more likely to spend the money on ‘private goods’, and particularly on food, clothing and schooling for their children. This generalisation may well be true as a matter of probability. However, not all women are more ‘responsible’ than all men.

There are some observers who argue that the evidence that targeting women makes any difference is inconclusive. Moreover, that procedure actually contains a gender bias. Fulfilment of the conditions is usually the responsibility of women, which intensifies gender inequity. So, that approach is discriminatory. It also invites potential conflict between couples.

The alternative approach is to give the cash directly to individuals. This is an essential defining feature of basic income. This will be defined in section 5, after first discussing the three design features that have predominated over the past two decades, namely targeting, selectivity and conditionality.

### 3. Targeting and Selectivity

In the debates on cash transfers, it was long regarded by mainstream policymakers as obvious that they should be ‘targeted’ on the poor, for fiscal reasons, for political reasons and for administrative reasons. The notion of targeting raises several major issues, the main ones being:

- How should the poor be identified?
- Should all the poor be included, even including those who in some way or another are ‘undeserving’, such as those supposedly ‘choosing to be lazy’?
- Do ‘targeted’ schemes reduce poverty and inequality by more or less than ‘universalistic’ schemes?

In developing countries, it is the first issue – identifying the poor – that has pre-occupied policymakers and social scientists. Strangely, lessons learned about the drawbacks of targeting from the early years of European welfare states have long been ignored. The most basic lesson of all is epitomised by a saying attributed to one of the designers of the European welfare states, Richard Titmuss, who quipped that benefits that are only for the poor are invariably poor benefits.

There are several forms of targeting—household means testing, proxy means testing, geographical targeting, community-based targeting and so-called self-targeting—but all of them try to focus cash transfers on ‘the poor’, using a notional poverty line. Yet any ‘poverty line’ is both arbitrary and subjective. Moreover, many people, probably

the majority in developing countries, who are in or near poverty experience fluctuating incomes, and may be just above the poverty line one week, just below it in another.

Another shortcoming of targeting welfare schemes is the irregularity and/or delay in certifying people as poor or not. This is unfair in several ways. The delay failure feature deserves more emphasis than it has received. Targeting cycles can be so infrequent that if an eligible person misses the registration window, or fails to qualify for some reason, they may not be able to access the scheme for a very long time. In India, for instance, procedures are so cumbersome that determining whether a household is poor is often done many years before entitlement to a benefit is put into effect.

In some areas of Mexico, registration has not been repeated for more than ten years. Grosh also confirmed this, stating that cash transfer recertification is rare and that eligibility testing for inclusion in cash transfers occurs every four or five years in Colombia and Ecuador, every two years in Brazil, and in a number of other countries such as Peru, Jamaica, Dominican Republic, Honduras it is just irregular.

Everywhere, targeting is riddled with errors, both conceptual and practical, due to ignorance, fear, mistakes, bureaucratic indifference and discretionary decision making. As a result, means testing always involves large errors of exclusion (eligible people do not benefit) and inclusion (ineligible people do benefit). Proxy-means tests that try to determine eligibility by some indicator correlated with income poverty, such as thatched roofs rather than tin, are no better.

Kidd argues that there is an 'inherent inaccuracy of poverty-based selection methodologies in developing countries. There is no selection methodology that can accurately identify the poor'. Even with the proxy-means test methodology, and even before households are surveyed, a high proportion of intended beneficiaries are excluded:

*When targeted at 10 per cent of the population, these design exclusion errors are around 60 percent. When targeted at 20 percent of the population, they are between 45 percent and 50 percent.*

In India, about half of all poor households do not have a BPL (below-poverty-line) card and about one-third of the non-poor (under the rules) have one. A study in the Indian state of Karnataka found that more than two-thirds of those questioned who were ineligible for BPL cards (for example, owning a water pump) in fact had cards, while a sixth of those genuinely eligible for the cards did not. Research in Gujarat, Delhi and Madhya Pradesh showed that a large proportion of those in dire need did not have BPL cards or were denied them for some spurious reason, such as not paying a local official a bribe. Ironically, often the poorest were least likely to have them.



Since 1992, the Ministry of Rural Development has conducted censuses to identify the number of poor, and procedures have become steadily more complex. The resultant chaos has been subject to withering criticism. As the Chairman of what became known as the *Saxena* Committee, set up to review social protection schemes, observed, the failure of targeting was shown up by the National Statistical Survey, which revealed that vast numbers of the poor were excluded from having a BPL card, while many who were not poor were allocated one.

There and elsewhere – everywhere – targeting also automatically creates notorious *poverty traps*, with accompanying moral hazards and immoral hazards. If a household obtains a benefit only if it is classified as poor, then it pays to stay poor. Increasing income to just above the poverty level would mean losing more than the extra earnings, implying that the person or household would face a marginal tax rate of over 100 per cent. So, there is a disincentive to earn extra. This moral hazard would also prompt an immoral hazard. Someone gaining a little more income will have an incentive to conceal it, so as not to lose entitlement to the benefit.

Targeted means-tested schemes also generate what one of us has defined as *precarity traps*, which have been under-appreciated by social policy planners and analysts. If someone receiving a means-tested (poverty-line tested) benefit were to undertake a short-term economic activity that would put him or her just above the poverty line, they would lose entitlement to the benefit, which might have taken a long time to gain in the first place. If the short-term activity ended, putting the person back below the poverty line, it might take a long time to regain entitlement to the cash benefit, leaving the person financially worse off over the period of moving in and out of economic activity

In addition, paradoxically, unless done very crudely and thus very inaccurately, means-testing inevitably mean high administrative costs. When evaluations measure the cost of a scheme, they should take account of the fact that funds spent on administration could have been used to give recipients more money.

Implicitly, targeting also addresses yesterday's, not tomorrow's, poverty. It aims to help those who have fallen into poverty, or who have been in it for a long time or permanently, rather than those in danger of falling into it. That may be justifiable in terms of priorities, yet the most effective way to reduce poverty is to prevent people falling into it, as preventing poverty costs less than helping people out of it.

The alternative to targeted schemes is a universalistic one, even though as will be discussed shortly, defining and operationalising universalism is also challenging. But, of course, the failings of targeting are very largely avoided by more universalistic schemes.

And several studies have considered whether targeted or universal schemes have more effect in reducing poverty. Due to exclusion errors, targeting performs worse.

In a study of cash transfer schemes in the four largest Latin American countries, it was found that targeted schemes on average reached less than half the poorest fifth of the population. Similar failings emerged in Brazil's *Bolsa Família* and Mexico's *Oportunidades*. The latter was found to be excluding 70% of the poorest 20% of eligible households. The former has not done well in this regard either. In one study the inclusion or leakage error, defined as the ratio of non-poor (the beneficiaries) to the total number of beneficiaries, was measured at 21 per cent in 2004 and 45.1 per cent in 2006.

Outside Latin America and the Caribbean, targeting has been just as unreliable. For instance, Georgia's Targeted Social Assistance programme excludes 46% of the poorest 10% of the population. Even cash transfer programmes believed to be well targeted, such as China's Minimum Livelihood Guarantee Scheme (also known as *Diabo*), do not do very well. In reviewing China's scheme, Ravallion concluded that:

*mis-targeting is evident in the available survey data. Some of this mis-targeting is due to discrepancies between survey incomes and the latent welfare metric used in targeting the program. There is also evidence of substantial leakage to those who should not be eligible, and incomplete coverage of those who should be, even when income and other relevant households characteristics are weighted optimally from the point of view of predicting program participation.*

Thus, in China, it should be no surprise that cities that have used more targeting have been shown to be less likely to reduce poverty. In short, universal schemes are more effective in reducing poverty and inequality than schemes ostensibly targeted on the poor. We will consider the meaning of universalism when defining basic income shortly. But it is clear from the assessments that more universalistic cash transfer schemes have performed better in several respects than targeted schemes.

This is not to state that all universalistic schemes avoid exclusion errors. However, the amount and type of exclusion give much less reason for concern. For instance, South Africa's old age pension reached 70 per cent of the elderly population in 2004, and apparently excluded 13 per cent of those eligible. However, this may well have been due to self-selected exclusion, with the affluent excluding themselves. Similarly, coverage of Georgia's universal pension in the poorest three deciles of the population is above 99 per cent, while in the richest decile it falls to 93.8 per cent. It is known that the pension is over three times as effective in reducing child poverty as the country's Targeted Social Assistance Poor Relief programme.

As far as exclusion errors are concerned, i.e., excluding the poor, these are minimal with universal schemes and these are better at including those living in poverty. Risk of inclusion errors is less, since universalistic schemes intentionally include the non-poor.

Mkandawire, in a strong invective against targeting, concluded that evidence to support it is very weak. He added that there was:

*a stubborn slew of empirical evidence suggesting that targeting is not effective in addressing issues of poverty (as broadly understood). Many studies clearly show that identifying the poor with the precision suggested in the theoretical models involves extremely high administrative costs and an administrative sophistication and capacity that may simply not exist in developing countries.*

He added that there was considerable 'evidence of poor countries that have significantly reduced poverty through universalistic approaches to social provision and from whose experiences much can be learnt'.

Ravallion also veered towards favouring universal approaches whilst keeping a modicum of pro-poor targeting. He argued that even if significant efforts were made to fix the shortcomings of targeting, given their costs and the political economy response to targeting, such an endeavour could undermine the political support for social policies. He concluded:

*'my own assessment is that it is not difficult in most settings today to avoid substantial leakage of benefits to the non-poor. The biggest challenge is to assure high coverage of the poor. This points to the appeal of combining universal eligibility-nobody is excluded-with a sensible degree of targeting, such that benefits are greater for poorer people.*

Another drawback of targeting cash transfer schemes is that they can be socially divisive, with perceptions of unfairness generating social tensions and animosity between in and out groups. In Malawi, for instance, community groups opposed targeting based on concerns that it would disrupt social relations. Targeting can also produce perverse outcomes, where people rid themselves of assets to ensure continued inclusion in the programme.

Universal schemes are less likely to cause such outcomes, and are more likely to attain buy-in from the middle classes, and in democratic settings be more likely to contribute to political stability. Moreover, a preference for universalism tends to be related to a strong concern for equity and for progressive taxes. Conversely, support for targeted intervention is generally represented in a set of policies and guided by an ideology in which equity is less prominent and in which tax is less progressive.

The former tends to generate more desirable social outcomes. Mkandawire argued that 'levels of equality are higher in societies pursuing universalistic policies than those that

rely on means-testing and other forms of selectivity'. In the same vein, Korpi and Palme invoked what they called 'the paradox of redistribution: The more we target benefits on the poor only, and the more concerned we are with creating equality via public transfers, the less likely we are to reduce poverty and inequality.'

Before proceeding to the hugely controversial issue of conditionality that has tended to accompany many innovative targeted cash transfer schemes in the past two decades, it is worth dwelling briefly on another feature of most schemes, that of *selectivity*.

Selectivity means directing the cash to groups with particular characteristics, on the grounds that they deserve help, rather than others. In India, for example, the most common schemes provide cash payments only to women with young children, those from Scheduled Castes or Tribes, those over a certain age (pension), and those with disabilities. Many selective schemes are also targeted, so that, for instance, only women with children *and* with low incomes receive the cash payments. Prominent advocates of cash transfers in India have presumed that they would be both selective and targeted, linked to the BPL card system.

Many of the failings of targeting also apply to selectivity. There is a tendency to omit people who are poor but who do not fall into the category selected for special treatment, and there are usually plenty of people supported by selective schemes who would not otherwise be singled out for special assistance. Moral and immoral hazards are also strong. If people receive support only if they are in a given situation, they will be induced to enter or stay in it, a form of poverty trap. This scarcely makes for good social policy.

## 4. The Lure of Conditionality

When the international community suddenly became enthusiastic about cash transfers around the turn of the century, it did so by embracing what became known as CCTs – conditional cash transfers. The World Bank led the crusade, pouring billions of dollars into loans to start and scale up CCT schemes. The Bank has defined them in a narrow way:

*'Conditional cash transfers are programs that transfer cash, generally to poor households, on the condition that those households make pre-specified investments in the human capital of their children.'*

Although it is not so simple as that implies, the idea of *conditionality* is in vogue all over the world. Essentially, it means granting benefits, usually cash transfers but possibly vouchers or access to subsidised social services, on condition that the beneficiary behaves in a certain pre-specified way or that the beneficiary ensures that others behave in some pre-specified way.

Donors, philanthropists, development agencies and the international financial agencies have been converted, and made funds and technical assistance available to those prepared to implement them. Conditional cash transfer schemes are now operating in more than 60 developing countries, up from two in 1997. One well-placed observer described conditional cash transfers (CCTs) as a 'magic bullet'. Research centres have grown, enriched by grants to conduct fancy evaluations of CCTs through equally invogue tools of Randomised Control Trials (RCTs).

In 2010, *The Economist* enthusiastically endorsed CCTs. Speculative gossip about Nobel Prizes for CCT designers and RCT gurus is spreading in the corridors of fashionable places. Before the hype is completely out of control, it is time for a reality check.

The basic rationale for CCTs – as conditional cash transfers are called everywhere now – is as follows. The premise is that poverty reflects an inter-generational reproduction of deprivation, and that this cycle must be broken by a policy intervention. Advocates of CCTs (henceforth, *conditionalists*) believe it is necessary to persuade people to behave responsibly, particularly towards their children. Obliging them to send their children to health clinics and to school implies that the conditionalists believe that without being pushed people would choose to behave irresponsibly. Behind the conditionality lies a simple belief, that the policymakers know what is best for the persons targeted for cash transfer.

There is also a tendency to believe that the irresponsible behaviour the conditions are intended to overcome stem from character deficiency, 'persistent misguidedness', ignorance or laziness, notably by parents, and that their actions do *not* stem from structural constraints preventing or discouraging them from doing what they would wish to do. Implicitly, conditionalists presume there are facilities available so that those required to behave in the designated ways can do so, and that the costs of using available facilities are low. Otherwise, it would be morally wrong to impose the conditionality.

While seemingly paradoxical (i.e., imposing obligations on rights), conditionalities have been advocated from a rights-based perspective too. Conditionalists reason that CCTs represent a way to bridge the gap between the legal basis of rights and their practical fulfilment. This can be achieved because it is recognized that the situational knowledge of beneficiaries, and their behaviour, are key factors for the realisation of rights.

More broadly, it is argued that conditionalities bind not only the beneficiaries, but also the public authorities to create the necessary conditions (for example, basic services availability) for their fulfilment. This is why CCTs are now presented as a vehicle for co-responsibility. Moreover, it is argued CCTs may have an important recursive function

that permits further enhancement of social service delivery and therefore maximizes opportunities for rights realization: lack of compliance with conditions does not have to trigger a punitive approach leading to the exclusion of the beneficiary.

Instead, non-fulfilment can also be understood as having a ‘revealing’ function, highlighting the vulnerability of individuals. This sheds light on the balance—or the lack of it—between the solutions provided and the needs of the beneficiary. Non-fulfilment could kick-start a positive feedback loop signalling to the authorities that perhaps the delivery of essential health and education services is lacking, or that there is a need for other services (for example, counselling or job training).

Consequently, further inquiry leads to progressively improved solutions. While for some analysts, this revealing function is a compelling case for persisting with conditions, there is no reason why UCTs cannot also realise rights as effectively, and have appropriate referral systems to ensure people are able to access the full range of social services available to them. All the above claims made by conditionalists can be contested. The arguments in favour of conditionality have been given extensive airing in recent times. For that reason, this paper will not dwell on them extensively. Instead it will highlight the pitfalls.

Conditionality could mean several things. It could refer to conditions that must be satisfied *before* a person can obtain a benefit or service, or it could refer to conditions that have to be satisfied *during* receipt once the benefit or service starts, or conceivably it could refer to conditions that must be satisfied for some period *after* the benefit has been received, perhaps on sufferance of having to pay back something. In practice, in most cases it has referred only to the second of these.

A condition could be either *binding* – i.e., imposing known or unknown penalties for not meeting it – or *moral* – i.e., involving a moral commitment to respect it, but without penalties should the person not fulfil the condition, for whatever reason. In practice, most CCTs have been binding, at least in their legislative formulations, although several ministers in charge of specific programmes have admitted in private that they would prefer to make them moral in character, rather than legally binding, with the implication that there will be sanctions if they are not met.

The more complex the conditionality, the more difficult it would be to universalise the scheme. Given the zeal of the *conditionalists* for social engineering, demonstrated by their enthusiasm for complex forms of conditional behaviour, this implies that in practice conditionality also involves *selectivity* – identifying those ‘deserving’ of treatment – and *targeting* – identifying those in need of treatment, usually by some measure of income poverty.

Stemming from the perceived success of the Mexican *Progresa* (now *Oportunidades*) and the Brazilian *Bolsa Familia*, 'conditional cash transfer' schemes have become enormously popular, to the point of being backed by the World Bank and to being exported to the USA, notably with the *Opportunity New York – Family Rewards* programme that was much more complex than the Brazilian and Mexican variants.

One should be impressed by some of the achievements of these schemes. *Bolsa Familia*, with over 60 million people receiving regular cash transfers, has alleviated income poverty in Brazil, and has apparently had a positive effect on child nutrition, school attendance and performance, on women's economic situation and on macro-economic recovery from the financial crisis. It has a fiscal advantage too; it has cost merely 0.5% of Brazil's GDP. Some observers have questioned some of those claims. But before reviewing the results, it is worth posing some hard questions that the trend to conditionality raises.

The most fundamental are: Is conditionality necessary for cash transfers to have the positive effects they seem to have? Is it possible that the conditions make the positive effects less than would otherwise be the case? And do conditions have effects that are bad in themselves, perhaps to the point where the good effects would be outweighed by the bad?

As it happens, in developing countries there are more unconditional cash transfer schemes than conditional schemes (Figure 1). But this is somewhat misleading, in that the former include social pensions, which to some extent operate in most countries. Nonetheless, UCTs do represent an important and legitimate part of the social protection landscape worldwide. The big question is: Do CCTs work better than Unconditional Cash Transfers (UCTs)? The answer, obviously enough, depends in part on what outcomes are chosen as important, and what are not.

One review of eight studies comparing CCTs and UCTs found that CCTs had more impact on schooling, health and nutrition. However, it noted that this was not necessarily the result of the conditionality as such; just as important may have been 'clear communication about the importance of using services and related support'. A study in Morocco found that just by labelling an *unconditional* transfer as an 'education grant' increased the likelihood that family behaviour would be directed towards that goal.

Another review of 35 cash transfer programmes found, unsurprisingly, that explicitly conditional and enforced CCTs had a bigger effect on school enrolment and attendance than unconditional schemes in those respects. But it was also found that UCTs also boosted school enrolment and attendance, showing that even without prompting

**Table 1.1**  
**Number of countries with at least one type of social safety net program, by region**

Program type	Region						Total of countries with at least one program
	Africa	East Asia and Pacific	Europe and Central Asia	Latin America and Caribbean	Middle East and North Africa	South Africa	
Conditional cash transfers	18	7	7	22	5	4	63
Unconditional cash transfers	41	11	29	28	14	7	130
Unconditional in-kind transfers	42	7	8	24	7	4	92
School feeding	45	12	23	28	16	7	131
Public works	39	9	17	17	7	5	94
Fee waivers	12	7	14	10	3	3	49
<b>Total number of countries in respective region</b>	<b>48</b>	<b>21</b>	<b>30</b>	<b>29</b>	<b>19</b>	<b>8</b>	<b>157</b>

Source ASPIRE, appendix C.

families wished to send children to school. And other benefits of unconditional transfers may be significant.

For example, in Malawi both conditional and unconditional cash transfers to adolescent girls resulted in higher school attendance rates, though the conditional transfers did better on this measure. However, teenage pregnancy and marriage rates dropped far more sharply among girls receiving the unconditional transfer, almost entirely due to the impact among girls who dropped out of school. Who can say which will have the more positive impact in the longer term?

This leads back to what should be seen as the primary criticisms of behavioural conditionality as a policy tool. It is definitionally paternalistic and imposes *controls* on the behaviour of some people that are not imposed on others. This is fundamentally inconsistent with freedom. And the more a benefit is made conditional on doing certain forms of behaviour to the satisfaction of bureaucrats, the more *insecure* it must be. This means its economic value to the recipient is reduced.

Conditionalists are quick to presume that it is the conditional mechanism that is pivotal in producing positive social outcomes. However, the efficiency of conditions has rarely been studied separately from the programmes that include them. For that reason, some argue that there is almost no evidence that conditions make any major difference and that it is fundamental attribution error to assign credit to the conditional mechanism itself for generating positive social effect; it is just the cash and messaging.



More study is needed to disaggregate the effects of the conditional mechanism and the actual cash payment, but we contend that unconditional cash plus non-binding social messaging can have equal or better results. Perhaps there is a need to recognize that the presumed effectiveness of conditions has attained something of the *doxa* status, or a kind of Emperor's Clothes. If the conditional mechanism is not the pivotal factor, then why not dispense with it and other behavioural conditionalities?

While basic income is not an automatic fulfiller of human rights, arguably it reduces the risk of human rights violations when it comes to the right to social protection, with the bonus of being freedom enhancing. However, when it comes to other rights (such as education and basic health care), like CCTs, basic incomes must be embedded in a wider social policy framework of adequate social services and monitoring, in order to facilitate rights maximisation .

Finally, there is also some evidence that conditionality has some unintended consequences in exacerbating social exclusion and worsening outcomes for specific disadvantaged groups. Often this is just because such groups are the least able to fulfil the conditions attached to the scheme. Those side effects should matter.

## 5. Basic Income

Despite what should be regarded as strong objections to conditionality, both conditional and unconditional cash transfer schemes are helping to legitimise the seemingly more radical version of providing everybody with a basic income. This is an old idea, in that over the ages philosophers, economists and others have proposed it in some form or another, and novelists have occasionally depicted society in which everybody has a basic income. The most famous depiction is Thomas More's *Utopia*, published over 500 years ago, in 1516.

A basic income may be defined as having the following features. It would involve paying a modest amount in cash or its equivalent to every individual, man and woman, equally, perhaps with a smaller amount paid to every child, with the money for the child paid to the mother or surrogate mother. This does not alter the recommendation that as far as adults are concerned, the payments should be individualised and paid equally to men and women.

It would be provided by the state as an *economic right*, that is, it would be paid unconditionally to every legal resident of a community, regardless of gender, marital or other relationship status, race or ethnic origin, age, religion and work status. It would be *non-withdrawable*. In other words, neither the government nor financial intermediaries would be entitled to deduct all or part of it to pay debts or for some other reason.

The universalism emphasised by proponents of a basic income is complex and controversial. In reality, no scheme is totally universal in the literal sense of the term. At national level, there are essentially two pragmatic approaches.

First, it could be taken to mean *every citizen*. But in that case it is likely to mean only citizens who are usually resident in the country, not the diaspora living or working on a long-term basis outside the country.

Second, it could be taken to mean *every legal resident*. In that case, there would need to be a definition of what counts as residency – usual and for a prolonged period. And the notion of ‘legal’ would need to be clarified. In short, one would probably define the universalism meant as all those who had been legally and usually (*de jure*) resident in the country for more than a certain period, such as two or three years.

This would be a pragmatic way of excluding ‘illegal’ migrants and also ‘legal’ migrants who had recently come to live and/or work in the country. We would prefer to call them ‘undocumented’ and ‘documented’. However they are called and differentiated, these groups must not be ignored, but should be supported by other means, without compromising the basic income system.

The same definitional rules would apply to local communities. Basically, the way it is defined could and should defuse the standard objection to a basic income, that it would encourage and reward migration into countries with a higher standard of living and/or with a basic income scheme. It actually could legitimately restrict legal migration to a greater extent than standard means-tested schemes, since in theory those give priority to the poorest, who are likely to be disproportionately made up of migrants.

So, the important aspects of a basic income are that it would be a modest amount, as the base of a social protection system, paid to *individuals*, paid in *cash*, paid *unconditionally*, paid *regularly*, paid *equally* and paid *universally*, and be *non-withdrawable*.

In the remainder of this paper, we will assess the differential impact of targeted and unconditional, targeted and conditional, universal and conditional, and universal and unconditional cash transfer schemes. Our normative position is that because freedom matters and because rights matter, universal and unconditional schemes like a basic income are in principle to be preferred, and could only be challenged if the welfare and development effects of other types of scheme were demonstrably and substantially superior.

We will use the term ‘basic income’ to refer to a cash transfer according roughly to the above definition at the individual level, and use the words ‘basic income system’ to refer to a situation in which everybody or all usual residents within a specified community are entitled to a basic income.

## 6. Cash Transfers and Poverty

The evidence of the impact of cash transfers in reducing poverty has become overwhelming in recent years. This was shown in a review of over 200 studies from middle-income and low-income countries around the world, and in several other general reviews. Since most of those reviewed were targeted schemes via some form of means-testing, rather than universal, we can only speculate how much more effective they would have been had they been universal and unconditional.

Ravallion argued that programmes like the *Bolsa Família* have played a crucial role in reducing poverty. He concluded that ‘in the absence of these transfers, and given the generally poor performance in terms of economic growth, it has been estimated that the [poverty] headcount index in Brazil would have been 5 percentage points higher in 2004’. A positive impact of conditional cash transfers on poverty at national level has also been observed in Argentina, Jamaica and Mexico too.

The impact of different types of cash transfer scheme will be considered more systematically in section 11 of the paper, devoted to the ‘transformative’ nature of cash transfers. But we can be confident that in general they have tended to reduce the incidence and depth of income poverty.

## 7. Macro-Economic Issues

At this point, we consider the evidence on the impact of cash transfers and basic incomes on the main economic variables – economic growth, inflation, income inequality and economic stability.

### A. The Impact on Economic Growth

Cash transfers, and universal basic income in particular, should have positive effects on economic growth, although if the supply of goods and services was demand inelastic, they could in theory simply increase prices.

The effects on growth can be split into *direct* effects, primarily through enabling low-income households to invest and boost productivity, and *indirect* effects, by altering the income distribution, which tends to raise growth.

In Latin America, there is evidence that social protection has made a positive contribution to economic growth and supports macro-economic stability. An ILO study of social protection systems in Latin America showed a positive correlation between social protection provision and economic growth. The study concluded:

*There is a positive link between an expansion of social protection systems and economic development. As recent studies have shown, there is no trade-off between redistribution and growth. In fact, Latin American countries with a higher social protection index, or even higher social spending, have had higher growth rates.*

According to this study, Peru, the Dominican Republic and Colombia are three countries that increased their 'social protection index' the most, and all of these grew faster than the Latin America average over the period analysed (2002-2012). Of course, this relationship is not casual, but there appears to be – at least - no inverse trade-off between expanding social protection systems and growth. The index was constructed by combining indicators of the extent of social spending, the efficiency of social assistance coverage, and average gaps between incomes of wage and non-wage earners.

According to UN estimates, cash transfers, defined broadly as including unconditional and conditional cash transfers and public works programmes, by 2016 covered some 718 million people in developing countries. To the extent that evaluations have concluded that these promote economic growth, they would contribute to the UN's Sustainable Development Goal Number 8: 'Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.' This is an extremely broad 'goal', and we will merely take note of this perspective.

In Brazil, the *Bolsa Família* cash transfer scheme has been credited not only with improved living conditions among the poor but also with increasing GDP growth. Most tellingly, it has done better in the latter regard than other policies. Since low-income households have a high propensity to consume, a large portion of the money received through *Bolsa Família* is spent on goods and basic necessities, and this has an income multiplier effect.

The *Bolsa Família* has enhanced local economies, as most of the money has been spent in local markets, generating demand for domestic goods and services. In many instances this favours small and micro-enterprises in rural areas, and the programme thus plays an important role in boosting job creation. The existence of this scheme before the crisis, and its expansion during it, may help explain why Brazil coped reasonably well and managed to sustain growth.

Cash transfers stimulate economic growth in three ways: individuals are enabled to invest more, the local economy is stimulated by increased spending, and the extra spending has a multiplier effect on economic growth. Hailu and Soares in their study of cash transfers in Brazil concluded:

*...well-designed and targeted social policies stimulate aggregate demand and consumption. The transmission mechanism is straightforward. A virtuous cycle of increases in the income of poorer families, together with wage growth, has enlarged the domestic market. Greater consumption of mass-market goods has led to growing labour demand for these same families, spurring further increases in their income and purchasing power.*

They added that one reason for Brazil not suffering as much as other countries during the financial crisis of 2008 was that the domestic economy had been strengthened while the reduction in income inequality due to cash transfers had boosted domestic production. During the crisis, the *Bolsa Família* was credited with increasing GDP growth and doing better in this regard than other interventions. Since low-income households have a high propensity to consume, much of the money received through *Bolsa Família* has been spent on local goods and basic necessities, which has a multiplier effect in the local economy.

Multiplier effects are crucial. An Institute for Applied Economic Research study supported this contention, arguing that the income multiplier is greatest when public transfers are directed to low-income families. They estimated that an increase of 1 per cent of GDP in *Bolsa Família* resulted in a positive change of 1.44 per cent in GDP and of 2.25 per cent in household income, while the same increase in interest payment raised GDP by only 0.71 per cent and household income by 1.34 per cent.

In another study of the growth effects of the programme, researchers concluded that it had the highest effect by a large margin compared to other monetary transfers. According to the model used, 'if the government increased *Bolsa Família* expenditures by 1 per cent of GDP, overall economic activity would grow by 1.78 per cent.' The evidence seems compelling that the scheme fosters economic growth. The effects at municipal level were also positive, with 'an average immediate increase of 0.6%, and an average lagged increase of 0.9% in the GDP per capita of a municipality.'

Some researchers are less convinced that *Bolsa Família* fosters growth. But empirical studies have been convincing. It seems the *Bolsa Família* enhances the dynamism of local economies, as the money is spent in local markets, generating demand for domestic goods and services. In many instances this favours small and micro-enterprises important in rural areas, and the programme thus plays an important role in boosting job creation too.

Qualitative data support this. In one study, small traders stated that they depended on the *Bolsa Família* for their enterprises to succeed. One trader reported that if it were to cease, they would lose 40 per cent of their business.

In Colombia, one study of the effects of the *Familias en Acción* cash transfers (now Más Familias en Acción) used luminosity data generated by satellites orbiting the earth, which served as a proxy for economic and per capita growth. The study concluded that 'the programme caused a positive effect of 0.11 in the growth rate and growth rate per capita on treated municipalities in 2004'. The research stressed that local economy effects were a source of macro-economic growth.

To reiterate, there is also compelling evidence that cash transfers have local economy effects that boost economic growth, and have strong multiplier effects. In Mexico, they seem to have helped recipients expand productive activities. The *Procampo* cash transfer scheme was introduced in 1994 to reduce the adverse impact of NAFTA on crop prices and the livelihoods of farmers. A study found that 'recipients were able to put to work at least some of the cash transferred to them, multiplying transfers into larger income effects. On average across recipients, a USD\$1 transfer resulted in USD\$2 of additional income, one directly and one indirectly.'

Others have concluded that cash transfers have boosted domestic demand, and that this is what most boosts economic growth. Cash transfers also contribute to growth by boosting entrepreneurialism and productive risk-taking. This may assume the form of being more prepared to experiment with new products or higher-yielding crops.

Evidence of the latter was found with *Oportunidades*; the programme increased the probability of spending on crop inputs by 4.8 percentage points. And more productive livestock were purchased. Households covered by the scheme were 17.1% (4.2 percentage points) more likely to own draught animals and 5.1% (3.6 percentage points) more likely to own production animals than control households, while increasing the value of draught animals owned were 21.4% greater and the value of production animals 16.6% greater.

Evidence of increased borrowing also suggested that cash transfers made households feel more confident about taking loans for productive purposes. In this regard, Gertler *et al* found a statistically significant effect of *Oportunidades* and concluded that:

*participation in the program has a significant effect of 0.4 percentage points (66.7 percent) on the probability of taking this type of loan. We take these findings as indicative that the increased investment in productive assets documented in the previous section resulted in an increase in agricultural income.*

They also estimated that investments in productive assets increased agricultural income by almost 10% after 18 months of benefits.

For similar reasons, Paraguay's *Tekoporã* conditional cash transfer had a significant impact on spurring agricultural activity. Over a period of 12 months, beneficiary

households, who were mainly own-account farmers, invested over 45 per cent more in production than non-beneficiary households, and were six per cent more likely to acquire extra livestock. The cash transfers also encouraged more extremely poor households to start investing in production.

Finally, besides unconditional child grants that are gaining popularity, there is one form of cash transfer that has proved successful and increasingly popular, namely *social pensions*, which have been universal (or nearly so) and non-contributory. These are a step towards a basic income in that they are unconditional, except for the obvious criterion of age for entitlement and for the remainder of a person's life.

The model, paradoxically was the scheme set up in apartheid South Africa. It was designed for ulterior motives, mainly to keep blacks in rural areas, but it proved to be a redistributive policy, as well as one favouring local economic growth.

There is compelling evidence that social pensions in Latin America have boosted local economies, so raising national economic growth. Social pensions benefit the entire household, and can reduce supply constraints limiting the activities of the working-age population and so unlocking economic potential. A study of Bolivia's *Bono Dignidad* social pension estimated that among beneficiaries in rural areas, consumption rose by twice the amount of the benefit. This suggests household production was aided by the transfers.

The injection of liquidity helps remove productivity constraints such as access to credit to purchase seeds and other agricultural inputs, and allows recipients, many of whom are farmers, to utilise their land better. A study of the impact of Brazil's social pension on households observed a high incidence of investment in productive capital. Pension transfers also support small enterprises. One study found that 'pension payday is when the wheel of the local economy goes round in rural Brazil, as pensioners purchase their monthly goods and service their debts.

In sum, cash transfers of various kinds have been shown to have a beneficial on economic growth, and by implication have done so by boosting local consumer and producer demand, and petty entrepreneurial activity. One would expect that this sort of economic effect would have correspondingly beneficial effects on economic inequality.

## **B. Cash Transfers and Inequality**

Cash transfers, and universal basic income-type schemes in particular, would boost growth by reducing inequality. Recent studies have shown that increases in inequality have ambivalent effects on growth in the short term, but have a clear adverse effect on

growth in the longer term, partly it seems by leading to a decline in public goods. One study found that high inequality may yield an economic equilibrium in which there is very little public investment in social services, such as public schooling. This lowers long-term economic growth.

There is also a popular view among development economists that high levels of inequality strengthen the ability of elites to build extractive political institutions that prevent low-income groups from raising their incomes. By expropriating their property and making deductions from their income, elites undercut the incentives to try to escape from poverty, a form of poverty trap that arises from an inequality of power in the state, thereby slowing economic growth.

A basic income system would tend to weaken this chain between inequality and low growth. As a reasonably designed basic income system would also tend to reduce *wealth inequality*, which is also correlated with lower economic growth, it should have beneficial effects through that link as well. And evidence suggests that high shares of the population living in poverty has an adverse effect on consumption, which lowers economic growth.

There is a growing feeling in the international community that cash transfers contribute to growth and macro-economic stability by promoting social peace and public confidence in governments, especially at times of economic uncertainty. Both poverty and income inequality are associated with an increased risk of social unrest. Combined, they undermine economic security and therefore threaten social peace and political and social stability. UNRISD has drawn similar conclusions:

*Inequality is not only a moral or ethical problem; it is increasingly seen as a key obstacle to sustainable development and poverty eradication. It not only affects people's enjoyment of human rights, and undermines social cohesion, social stability and well-being, but also has a clear negative impact on economic development, for example on macroeconomic stability and growth.*

Cash transfers can support social peace by helping to reduce economic and social inequalities. In that regard, the evidence is quite encouraging.

Studies of the impact of cash transfers on income distribution in Latin America show that the *Bolsa Familia* and *Oportunidades* reduced inequality, as measured by the gini coefficient, by about 2.7%. Brazil's almost universal social pension, has an even higher impact and accounts for an 8.8% reduction in inequality.

In South Africa, the combined effect of the principal national cash transfers – social Old Age Pension, Disability Grant and Child Support Grant – were estimated to have reduced



the 'the number of individuals in poverty from 40% to 24%. The grant system also strongly reduces inequality – the gini coefficient (on per capita household expenditure) fell from 0.67 before grants to 0.62 after them.

Cash transfers, and social protection in general, can contain inequality and support equitable growth. Whatever the causal link, we do know that there is much less inequality in countries with high social expenditure than in those with lower social expenditure, as measured by gini coefficients of between 0.225 and 0.261 in the former, compared with above 0.3 in the latter.

Social peace is a requisite for growth. It contributes to nation-building by renewing/reinforcing social solidarity and the social contract between state and citizens, improving governance and equity, and establishing conditions conducive to political and social stability. More equal societies also seem to perform better across a range of other social dimensions too. More equal societies are likely to be more open to reforms (e.g. trade) and often this can be pro-growth. All of this lays the foundations for economic prosperity and stability.

### **C. The Impact on Inflation**

Some critics contend that cash transfers, and particularly basic incomes, would be inflationary, primarily by increasing the demand for food and other commodities. This neglects the supply side response. There is no reason to believe that supply would not respond to higher demand, since the money would be spent mostly on basic goods and services.

To lessen the likelihood of initial inflation, stocks of food and other basic goods could be released until there was time for supply to increase through the market. Again, evidence suggests that the influx of money into local economies via transfers leads to a rapid increase in the supply of basic goods and services, partly by encouraging people to grow more food crops, make more clothes and so on, partly by inducing merchants to direct more goods and services into these economies.

The actual evidence on inflation is encouraging. For instance, a study of direct food aid versus direct cash transfers in rural Mexico found that providing free food tended to lower food prices, which discouraged local farmers from growing more food and depressed their income. By contrast, the direct cash transfers had no effect on prices, presumably because the additional demand gave producers an incentive to supply more food and other items to the local market.

Relevantly, a High-Level Panel on Humanitarian Cash Transfers concluded that in general inflationary risks are low and that 'local markets have responded to cash injections

without causing inflation and it has generated positive impacts on local economies'. However, it added a cautionary caveat suggesting 'sometimes markets are too weak or supply cannot respond, in which case cash transfers would not be appropriate and in some cases could lead to inflation'.

What we can say is that most studies of cash transfers in a wide range of contexts have not observed any inflationary effects. However, there are some examples when inflation has occurred. A case study in Northern Uganda of a short-term and small-scale cash transfer to 1,500 households in two instalments of USD150 showed that the cash transfers:

*produced a temporary inflation of livestock prices at the local level. Prices in local markets and informal transactions became 10 to 30 per cent higher than expected for the season. This was mainly attributed to an inelastic supply caused by high transaction costs and incomplete information. Inflation was also the result of an inelastic demand, as beneficiary preferences were directed towards a few local products.*

This 'flash' inflation lasted two week and occurred in an unstructured market. Reflecting on this study Ravallion argues that cash payments to poor people 'tend to increase demand for food and, therefore, increase local prices of non-traded foods (with adverse effects for poor consumers), while payments in the form of food have the opposite effect (with adverse effects for poor producers)'.

In some cases, cash transfers may produce short-term price inflation, where markets are undeveloped or if the transfer amount is large relative to local living standards. In those circumstances, complementary policies may be required, including informing potential suppliers of goods and services to expect greater demand. But these are surely surmountable challenges.

#### **D. Cash Transfers as Macro-Economic Stabiliser – Revival of Keynesianism?**

There is some evidence that cash transfers have been used strategically as macro-economic stabilisers, and that this quasi-Keynesian policy has been rather effective. One case where a government has used them in that way also happens to be the world's largest unconditional cash transfer scheme, even though it was only temporary and was targeted.

This was the *Bantuan Langsung Tunai* scheme in Indonesia. Originally introduced to compensate the poor for cutting the fuel subsidy (discussed later), the BLT was stepped up in 2009 as a temporary response to the financial crisis, with the amount worth on average 15 per cent of the average monthly expenditure of recipient households.

Directed at the poorest 30 per cent of households, it reached over 18 million households in 2009. The failings were the standard defects of all targeted means-tested schemes – many of the households that gained the cash were not in the bottom 30 per cent, and many of the bottom 30 per cent of households did not receive the benefit.

In total, Indonesia directed 7 per cent of its stimulus package to low-income households in cash payments. In 2009, spending on social protection was increased by over 34 per cent or 20 trillion rupiah (US\$2.3 billion). The BLT payment period was extended to an additional two months, and the scheme was allocated an extra IDR2.3 trillion (US\$0.2 billion). And another conditional cash transfer scheme (PKH) was expanded twice during the crisis to provide support to pregnant women and families with young children. This combination helped to limit the adverse impact of the crisis. In many cases, beneficiaries used the money for their children's school and healthcare, as well as for food and other basic necessities.

Another interesting example is what happened in Brazil. The country experienced a sharp but, by international comparison, relatively brief recession as a result of the global financial crisis of 2007-08. As part of a national stimulus package, the government raised the value of the *Bolsa Família* by 10 per cent, giving it 1.5 per cent of the stimulus package.

The stated aim was to enable poor households to cope with the additional hardships engendered by the crisis. The eligibility criteria were relaxed. The level of income below which households were eligible was raised from a monthly income of the equivalent of US\$71 to US\$82, resulting in coverage being extended to an additional 1.8 million families, giving a total of 12.8 million families.

In analysing the outcomes, the International Policy Centre for Inclusive Growth concluded that during the financial crisis the *Bolsa Família* modifications softened the adverse welfare effects, by providing reliable income, sustaining household consumption and avoiding a decline in economic activity. The existence of the scheme, and its expansion during the crisis, supports the view that cash transfers can be used as automatic stabilizers that can quickly scaled up when needed. This also explains why Brazil rode out the crisis reasonably well.

Other middle-income countries deployed additional cash through their cash transfer infrastructure. The Philippines disbursed an additional US\$11 to each Social Security System pensioner as a one-off payment in September 2008. South Africa extended its Child Support Grants to all those up to age 18. This was intended to result in an additional two million children benefiting from this publicly-funded unconditional cash transfer.

Another country that responded by using cash transfers as a stabiliser was Jordan, which provided targeted cash support for the most vulnerable groups. The monthly minimum wage was raised from US\$155 to US\$211 and funding to the National Aid Fund, which provides assistance to low-income families, was increased. The Fund then in 2009 extended the number of families provided with monthly cash transfers from 12,335 to 82,694 families, roughly 7 per cent of the population. The government also raised the level of income for cutting off aid under the Special Cases Programme for the disabled and elderly from US\$282 to US\$352, and increased the amount given.

In some richer countries, cash transfers were also used as a stabilizer during the financial crisis. For example, although only moderately used, transfers proved effective in Australia's successful income-led response to the crisis. Australia opted for a multi-faceted response, combining financial sector stabilisation, extension of social protection for the most vulnerable, and labour market measures to stimulate job creation.

The subsequent avoidance of recession is credited to the underlying strength of the economy, the continuing demand for commodities and, perhaps most importantly, swift and decisive mobilization of resources to address the crisis. Thus, fiscal measures were introduced early and in stages to respond to the changing nature of the crisis, beginning with the *Economic Security Strategy* in October 2008 (US\$10.3 billion), followed by the *Nation Building and Jobs Plan*, a bigger stimulus package in early 2009 (US\$41.6 billion). Australia allocated 41 per cent of its stimulus package to social protection through one-off payments to low- and mid- income families, amounted to 29.5% to pensioners, and 11.7 per cent to carers. Coming to about 1% of GDP, one-off payments were made to certain vulnerable groups, with pensioners receiving between A\$1,400 and A\$2,100, depending on their income, and low- and middle-income earners receiving \$A1,000 per child.

The Australian experience demonstrated the effectiveness of income-led responses to a crisis, where the pre-existing public finance position allows. Putting more disposable income into the hands of low- and middle-income groups not only limited the effects of the downturn but constituted an important part of the exit strategy, by boosting consumption and aggregate demand, especially as these groups have a high marginal propensity to consume.

This restored business and consumer confidence to levels higher than in other G7 countries. Supported by fiscal stimuli, resilient household spending and increased public consumption led to a resurgence in growth. The OECD highlighted the country's

fiscal stimulus package as being particularly effective in its support of employment, concluding that without those measures, growth would have contracted by 1.3 per cent between 2008 and 2009.

In the USA, the income-led approach used during the financial crisis also showed that cash transfers aided the recovery. The US Congressional Budget Office estimated that they played a particularly important role, calculating that they had an output multiplier of 0.8 to 2.1. Compared to other measures, such as tax reductions for higher-income earners and extension of credit to first-time homebuyers, the impact of what were moderate transfers was greater.

A lesson is that macro-economic stability better assured if countries build up social protection measure during prosperous periods to be prepared for times when adversity strikes. Countries having reasonably comprehensive social protection systems in place were best able to overcome the crisis. Schemes that were already operating provided policy-makers with possibilities to respond rapidly to help sustain aggregate demand and to offer protection to those affected. These countries will likely be those best able to cope with future crises.

As macro-economic stabilisers, cash transfers are particularly effective, since they can take effect with less delay than other discretionary fiscal measures. They have an inbuilt counter-cyclical impact that can act as automatic stabilizer. And the simplicity of a basic income means that if were in place as a system could be the most effective stabilizer.

On average, social protection accounted for 25% of fiscal stimulus packages. Almost certainly, the impact would have been greater had a larger share of the packages been devoted to social protection spending. Just imagine what could have been accomplished if the Quantitative Easing (QE) measures used in some counties had been used to finance a basic income.

For countries like the USA and UK, this was a lost opportunity. The \$4.5 trillion in QE by the US Federal Reserve was enough to have given \$56,000 to every household in the country. Similarly, had the UK's £375 billion of QE been used to pay a basic income, everyone legally resident could have received £50 a week for two years. Inequality would have been reduced, economic security improved, growth boosted and social tensions calmed. Instead QE generated new asset bubbles, increased income inequality and fuelled a politics of intolerance and populism.

Intriguingly, had the European Central Bank diverted its QE programme, estimated to come to 1,800 billion euros over two years, to paying equal basic incomes to everybody

in, say, the poorest regions of eastern and central Europe, it would have boosted economic growth, reduced inter-regional inequality and tended to reduce distress migration from depressed regions to the north of Europe, where it was sadly fanning xenophobia and populist politics.

In sum, the recent financial crisis helped to demonstrate the potential roles of cash transfers, including basic income type schemes, by highlighting the interventions that could be most effective in maintaining or restoring macro-economic stability. The ILO's Bachelet Report on the Social Protection Floor argued that social protection played a pivotal role in stabilizing aggregate demand during the crisis and showed that social protection can increase resilience against economic shocks, so helping to accelerate recovery and strengthening more inclusive and sustainable development.

## 8. The Transformative Potential of Cash Transfers

It is a cliché that poverty is a multi-dimensional phenomenon, encompassing income-deprivation, malnutrition, ill-health, lack of access to sanitation, fresh water and healthcare, and lack of access to schooling and other means of human development. Obviously, no single policy can rectify all of this. But what we want to suggest here is that properly designed cash transfers can play an integral part in breaking the shackles of poverty, the reinforcing loops of deprivation, and that basic income in particular can do so.

This section considers what might be called micro-level effects, which may translate into macro-economic and societal effects. Unlike subsidy schemes and direct transfers of selected goods and services, cash transfers, most particularly universal basic incomes, have the potential to be transformative. By this we mean that they can induce welfare, economic and structural changes that result in a change in the overall social and economic system. This was the main conclusion of the first large-scale pilot of basic income in India.

We will begin this brief review with the welfare effects, and then move to equity outcomes, economic effects and what might best be described as emancipatory effects.

### A. Nutrition and Health

One of the most researched aspects of cash transfers, and particularly of conditional and unconditional variants, is the effect on health. In theory and by hypothesis, the main health-related effects of cash transfers can be listed as follows:

- a. They improve maternal health, thereby reducing female morbidity, health problems related to childbirth, and maternal mortality.
- b. They improve child nutrition, resulting in less stunting and improved weight-for-age and height-for-age measurements.
- c. They raise the incidence of timely vaccinations of children against diseases such as polio, diphtheria and tetanus.
- d. They lead to greater use of health services, including preventive services and services involving user fees.

An occasional observer has claimed that cash transfers do not have any effect on nutrition. And some studies have been sceptical about the impact on child nutrition and health, as in Honduras and Brazil. But most of the many empirical studies have found strong positive effects on child nutrition, child and adult health status, the incidence and severity of illness, and use and effectiveness of medical services.

For instance, in Colombia, the country's CCT resulted in an improvement in the average height-for-age among children. In Mexico, the CCT reduced stunting among babies by 39 per cent among girls and 19 per cent among boys. But the trouble with many studies is that it is unclear as to how much of the effect is due to the conditionality applied by the scheme and how much to the cash. However, there is also evidence to show that unconditional transfers have similar positive effects.

In Namibia, a pilot basic income scheme covering about 1,000 villagers, who were all provided with a basic income for one year, yielded some very relevant evidence. The Namibian pilot is worth highlighting because it was a genuine basic income scheme, even if 'randomistas' would object to the lack of control groups. Using the World Health Organisation's (WHO's) z-score methodology, within six months of the start of the unconditional transfers, the weight-for-age figures for infants aged 0–5 years improved dramatically, with underweight children moving towards the norm and overweight children also doing so due to improved diets. No pressure was put on families to spend the cash in any particular way. Quite simply, they acted as most would, looking after the interests of their children.

Later, a set of three pilot basic income schemes were undertaken in India in 2011-13, under the general direction of one of us and done in collaboration with the Self-Employed Women's Association of India. In the largest of these, conducted in the State of Madhya Pradesh, about 6,000 men, women and children in eight villages were provided with modest basic incomes for 18 months, and what happened to them was compared with what took place among a similar number of people in 12 otherwise similar villages.

One of the findings was that the distribution of z-scores for children aged from birth to age five went from being skewed well to the left, indicating widespread malnutrition, to being almost a normal distribution. Even more encouraging was the fact that the distribution for girls went from being more skewed than for boys, implying worse malnutrition, to being very similar to boys. The individualised basic incomes seems to have helped in assuring girls of better access, and thus improved their relative and absolute health status.

Unconditional transfers have also been shown to lead to dietary diversity, a development associated with enhanced child nutritional status. However, since conditional schemes greatly outnumber unconditional schemes, there is more evidence on their effects. Thus, Sri Lanka's well-established *Samruddhi* unconditional cash scheme led to improved child nutrition.

In many places, including India, CCTs have been associated with a decline in neonatal and perinatal deaths. There is also evidence, mainly from Latin America, that CCTs boost the use of preventive health services, being associated with more health check-ups. The same effect has also been found in India and in the basic income pilot in Namibia.

This is not surprising, or should not be. Being rational, people soon work out that it is beneficial to have health check-ups if they can afford it and have the time to do so, and if the facilities are available. Thus, in those Namibian villages, the basic income meant that visits to the local clinic became affordable, while the clinic could improve the premises and raise the morale and status of the nurses.

With cash transfers, small user fees become more affordable, although this is not to argue against fee waivers for individuals or groups that are chronically poor or prone to illness and medical expenses. There is also evidence that if people have cash with which to pay for medical services, this leads to pressure on public and private services to improve what they provide.

In the basic income pilots in Madhya Pradesh, the findings showed there were improvements in welfare – improved sanitation, child nutrition, diets, health and healthcare and school registration, attendance and performance. The nutrition effects should be particularly appreciated, in that all experts have long agreed that, if the poor had access to the resources to obtain adequate food, India since the Green Revolution has had, in principle, food self-sufficiency. But in terms of the Global Hunger Index, in 2016 India ranked 97<sup>th</sup> out of 118 countries for which comparable data were available. In other words, widespread hunger is a failure of the distribution system. A basic income would enable those currently unable to obtain adequate food to do so.



## B. Schooling

Probably more research has been devoted to exploring the impact of cash transfers on schooling than on any other aspect. The following are the primary education-related hypotheses associated with cash transfers:

- a. They raise school enrolment.
- b. They raise school attendance
- c. They improve school performance.
- d. They reduce school drop-out rates.
- e. They lead to prolonged schooling, mainly through the effects of (a) to (d).
- f. They reduce child labour that disrupts schooling, through an income effect and through the increased propensity to attend and continue schooling.
- g. They reduce inequalities in school attendance and attainment associated with family background, wealth and household income.
- h. They reduce gender inequalities in all the above respects.

In many of these respects, there is evidence that cash transfers in various countries have had some impact. For instance, in Nicaragua, the *Red de Protección Social* cash transfer has been shown to have achieved a significant set of effects on schooling even though it was a small programme. It was associated with an 18 per cent increase in school enrolment rates among children aged seven to 13. Paraguay's *Tekoporá* programme increased enrolment rates by 2.5 per cent and attendance rate by between 5 and 8 percentage points among the children in beneficiary families.

In Mexico, *Progres a/Oportunidades* is associated with higher school enrolment for children in families covered by the programme. In rural areas, where the number of children entering the first grade of secondary school rose by 85 per cent and second grade by 47 per cent. Importantly, drop-out rates decreased by 24 per cent, with a corresponding rise in completion rates of 23 per cent for rural secondary schools. These results indicate an overall increase in completed years of schooling of about 10 per cent for children in families covered by *Oportunidades*. Significantly, this is predicted to increase children's future permanent earnings by about eight per cent when becoming adults. Crucially, the *Oportunidades* programme has practically eradicated the gender gaps in the enrolment of boys and girls in secondary schools. This is especially true in rural areas.

Cash transfer have shown an impact on raised school attendance too, although the effect is variable. In Brazil, school attendance amongst poor children rose by 4 per cent

as a result of participation in *Bolsa Familia*, with an average enrolment rates high school in Brazil are already high. Studies for Colombia, find little impact of *Familias en Acción* school attendance rates amongst children aged eight to 11. However, among children aged 12 to 17, the effect of the programme becomes significant and positive, with about 10 per cent improvement in rural areas and 5.2 per cent improvement in urban areas.

The Dominican Republic's Solidarity programme has been found to increase the probability of attending school by 14 percentage points among students aged 14 to 16. In Jamaica, the Programme of Advancement Through Health and Education increases school attendance among 6-to-17-year-old children by half a day per month. This is significant considering the high rates of attendance (96%). Unconditional cash transfers, like social pensions can also have important effects on children's education. Recipients of social pensions pay the school fees and associated schooling expenses of their grandchildren. This has been the case in Namibia and South Africa.

The schooling effects have probably attracted the most comment and research attention. One Indian commentator, seemingly unaware of the basic income pilots, claimed that a basic income would not solve the problem of 'human capital'. No single measure could do that, even if one could give a satisfactory meaning to 'human capital'. However, had he examined the findings from the pilots, he would have seen that the basic incomes sharply improved schooling, particularly for the poorest and most disadvantaged. They also improved children's ability to learn by improving their nutrition and health.

Closely related to schooling is the extent of child labour. In this regard, the findings from the Indian basic income pilots in Madhya Pradesh deserve special mention. At first glance, after a year of the basic incomes having been paid, the proportion of children doing economic activity was only marginally down.

However on closer inspection, what had happened was that the number of children doing casual wage labour was down, and the average amount of time allocated to casual wage labour was down. Meanwhile, the amount of time devoted to own-account work on family plots or helping out around the home was up. And when asked, at the outset and after one year, the parents reported that the own-account work was less likely to interfere with schooling. The net effect was surely positive.

The impact of cash transfers on child labour is somewhat mixed. In Brazil, a study of the *Child Labour Eradication Programme (PETI)*, tasked specifically with eradicating the worst forms of child labour in rural areas, concluded that it increased children's time in school, improved academic success, and reduced hazardous labour activity. The effect of the *Bolsa Escola* school grant is estimated to have reduced the probability of labour among girls aged 6 to 15 in urban and rural areas, and among boys aged 11 to 15 years

in urban areas. However, that study and another concluded that the effect of the transfer was insufficient to compensate for the income that could be earned from child labour.

Overall, the studies on the impact of *Bolsa Família* on child labour report only small effects. In Mexico, small but significant reductions in child labour have been documented, although no notable reduction was found for boys aged 16 to 17. For the Paraguayan *Tekoporá* programme, it was only possible to identify a positive impact on child labour in those aged 4 to 9 years. In other groups, children covered by the programme were found to combine labour with school, rather than stopping labour.

In Colombia, studies of *Familias en Acción* indicate a significant reduction in child labour in rural areas, especially among children aged between 10 and 13. Similar effects have been found with Nicaragua's *Red de Protección Social* for children in the same age group, with a reported 8.8 per cent reduction in child labour. And in Ecuador a study found that child labour fell by 17 per cent as a result of families' participation in the *Bono de Desarrollo Humano* cash transfer scheme. Elsewhere, the impact of transfers on child labour seem to have been minimal. In Costa Rica, for example, *Superémonos* increased school attendance and educational attainment among poor children, but there was no evidence of reduced child labour.

There is one welfare-related claim made by critics of cash transfers – and particularly on universalistic unconditional schemes – that deserves special attention. This is that they will lead to wasteful spending on so-called '*private bads*' or what are sometimes called '*temptation goods*', such as alcohol, drugs and tobacco.

A great deal of evidence has been gathered on this around the world, and the consensus seems to be that cash transfers do not lead to much if any increase in spending on such items. One could say that they are what economists call 'inferior goods', that is, the demand for them falls as income rises. This seems to be consistent across the world, although tobacco is an inferior good, alcohol a normal good.

But the most interesting point is why expenditure falls with a rise in income associated with cash transfers. There seems to be a substitution effect, so that households spend more on schooling and healthcare, for example. There seems to be a 'social messaging' effect, in which implicitly or explicitly the payment of the cash transfer suggests recipients should try to spend the money wisely. One might add that there may be a sense of moral suasion, as recipients encourage their relatives and neighbours to spend it on investment or welfare goods and services.

A relevant finding occurred in the basic income pilots in India. It was found that many more of the households receiving basic incomes reduced their consumption of alcohol

and tobacco than increased it. When asked why this was the case, the most common response was that the men, in particular, had more work and labour to do, and were not sitting around smoking and drinking. That seems to make sense.

### **C. Equity**

Cash transfers of various types have been associated with positive equity effects, that is, they have tended to improve the situation of disadvantaged groups, not only in absolute terms but in relative terms as well. But this is not always the case. As mentioned earlier, conditional schemes can easily intensify forms of social exclusion. Again, it is universalistic, unconditional schemes that seem to perform better in equity terms.

In the Indian basic income pilots (the second covering a tribal village area), not only did women gain more than men, and girls more than boys, in terms of nutrition, health, access to healthcare, and schooling, but the villagers with various forms of disability benefited most of all. And it was striking that in almost all respects the scheduled-caste and scheduled-tribal households benefited more than upper caste families.

### **D. Economic effects**

Cash transfers have been associated with increases in economic activity and production, as emphasised in the section on their impact on economic growth. This was shown clearly in the Madhya Pradesh and Namibian pilot basic income schemes. In doing so, they also contradicted the standard criticism that giving people cash would induce 'laziness', reduce labour supply and reduce the amount of work done.

According to the ODI's appraisal of cash transfers cited earlier, over half the studies that have considered the impact on adult work, as defined by labour force participation, cash transfers have not had a significant impact on the amount of labour supplied. Of those reporting that did show a significant effect among working-age adults, the majority found an increase in labour. And where there were reductions in work participation, they seemed to be desirable, reflecting a reduction in labour among the elderly and those caring for dependents, or reductions in casual labour.

Another case of unconditional cash transfers not leading to a reduction in work and labour seems to have been the very large-scale and targeted BLT scheme in Indonesia described earlier. Recipients were found to have increased their employment rate and were less likely to have left their main economic activity than non-recipients.

Social pensions tend to act as desirable work disincentive by reducing the labour supply of elderly recipients. However, they can increase the labour supply of working-age household members. Social pensions can reduce income and childcare constraints and therefore enable the household to improve their allocation of labour resources. A study from South Africa's confirmed this finding, with longitudinal data which followed household changes around pension receipt.

In Chile, the main cash transfer intended to reduce extreme poverty is an integrated development scheme, *Chile Solidario* (now *Ingreso Ético Familiar*). This seems to have led to an increased labour supply from household members other than the main earner, by reducing credit and care constraints. One study found a significant increase in wives' employment in households covered by the scheme of 4-6 percentage points (depending on cohort). Effects such as these suggests that impact of transfers on productivity and growth are positive.

In the Madhya Pradesh pilots, the amount of work and labour increased following the introduction of the basic incomes. But had a standard labour force approach been adopted, much of the increase would have been missed in the data. This is because the biggest effect was to increase the amount of secondary economic activity, both in terms of new 'businesses' or entrepreneurial ventures and in terms of more time doing own-account production. The growth of such work was particularly pronounced among women.

## **E. Emancipatory effects**

There is one final set of effects that have received the least attention from researchers. This is perhaps because economists, particularly those trained in neo-classical economics and econometrics, are not very interested in philosophical aspects of life. It is our view that all policies should be evaluated, in part at least, by whether or not they enhance the freedom of those affected. One criticism of RCTs, the popular methodology for evaluating cash transfers, is that they are inadequate for capturing emancipatory effects.

In that regard, the contention is that in almost all communities in developing countries, money is really a *scarce commodity*. If any commodity is scarce, relative to need and demand, its price will tend to rise. So, particularly but not only in rural communities, moneylenders and landlords can and do charge exorbitant rates of interest on all forms of loan, and local shops can charge high rates on credit. In such circumstances, a basic income system lowers the price of money, making it less of a scarce commodity, by providing liquidity, driving down rates of interest, and thereby raising the real value of disposable income.

In addition, the individual nature of a basic income enables people to have greater control over their decision-making, which of course has been a boon for many women, and for people with disabilities, who have typically faced cultural and other barriers. For empowerment to be meaningful, individual income security may not be sufficient, but it is certainly necessary.

## 9. How could basic income be afforded?

Of course, one of the major questions is how to pay for cash transfers. For many years, it was just presumed that extensive cash transfers in developing countries was impractical because there was no way to pay for them. That is no longer taken as granted.

Paradoxically, paying for basic incomes could be easier in many developing countries than in rich industrialised countries that have complex welfare systems to unravel. One obvious difficulty is that tax systems tend to be under-developed, leaving it hard for governments to raise income from direct taxation. Fortunately, however, there are two major sources of funding – fossil fuel subsidies and food subsidies.

One development has brought the green or ecological case for basic income to the fore. Across the world, in rich countries and in poor, governments have long used fossil fuel subsidies as a way of reducing poverty, mainly by keeping the price of fuel down. This, of course, has led to more consumption, or use, of fossil fuels, which has increased pollution. Governments have then been most reluctant to raise taxes on fossil fuels, with the same rationale, that it would raise the cost of living for the poor.

The logic of this twin policy has always been weak. Subsidies on fuels are regressive, since the rich consume more energy, and thus gain more from the subsidies. The reluctance to put taxes on the use of fuel is equally regressive, for the same reasons. To add to the problem, governments have been hesitant about changing the situation, for fear of alienating voters.

Here is where a basic income could resolve the impasse. If the subsidies on fossil fuels were removed, fuel prices would rise. Therefore, the vast amount of money governments spend on those subsidies could be redirected to what have been called 'green dividends', paid to everybody equally. This would be transparent compensation, and it would be progressive, since those consuming more fossil fuels would pay more and the dividend would be worth more for those with low-incomes.

In addition, if fossil fuels were properly taxed, to cover for the externalities, that is, the social costs from CO<sub>2</sub> emissions and the premature deaths caused by pollution, then the revenue from the extra fossil fuel taxes could be used to top up the green dividends. In

this double way, low-income citizens would be economically better off. And, of course, the policy switch would tend to reduce use of fossil fuel energy, reduce pollution and improve life expectancy.

Some advocates, such as climate scientist James Hansen, have argued that 100 per cent of carbon tax revenues should be given out as equal green dividends. Others have suggested that companies using fossil fuels for production should be compensated with part of the money collected, at least for a period in which to convert to other sources of energy. Either way, here is a source of funding a basic income, a way of building up the financial base for payment, and one justifiable on social justice principles.

One country where the conversion of fuel subsidy to something close to a basic income has been done is Iran. In December 2010, the government increased food and energy prices by up to 20 times, in a bid to slash its costly subsidy bill estimated at US\$50-60 billion and curb wasteful energy use. At the same time, households began to receive a regular cash grant to compensate for the increased cost of living. The grants cost \$30 billion a year, with each citizen receiving about \$40 a month. Another \$15 billion of the money saved from the fuel subsidies were allocated to help energy-intensive firms reduce their energy use.

The payments of equal grants was powerfully redistributive. The grant was universal and unconditional, with the one proviso that those who had an income that made them subject to income tax had to submit tax returns. For this reason, many of the richer citizens (about 10 per cent of the total) preferred not to apply to receive the basic income.

Over two-thirds of Iranian adults now receive a government payment, a higher proportion than in any country in the world, with over 90 per cent of the payments going directly into bank accounts. For the poor, who benefited least from subsidised energy prices, the grant has more than compensated for any loss and has had a significant effect in reducing poverty and inequality, especially in rural areas.

Moreover, the grant scheme costs the public budget about half what fuel subsidies were costing, though some politicians and clerics, partly for political reasons, have pressed for means testing to reduce the gross cost. Critics also attacked it as inflationary; there was an initial inflationary spurt when the scheme was launched, but it was kept in check by temporary government measures and has now subsided. Since then, it has been estimated that the reform saved government over \$6 billion a year. And best of all, since the cash grants were introduced, the poverty headcount index in rural Iran has fallen from 37 per cent to 17 per cent, and the urban rate has fallen from 8 per cent to three per cent.

Other countries that have moved to replace fuel subsidies with cash transfers include Egypt. In 2014, it was estimated that over 7 per cent of GDP was being spent on energy subsidies, and that over two-thirds of all energy subsidies were going to the richest 40 per cent of the population, with well over a third going to the top 20 per cent. As the Minister of Social Solidarity admitted in a public speech, *'Fuel subsidies (6% of GDP): were not only higher than health and education public expenditures combined, but also mainly benefiting the rich.'*

In Egypt's case (as in many other countries), it was recognised that at the same time, in 2014, food subsidies amounted to 9 per cent of GDP, which dwarfed the share of national income being spent on all social transfers, 0.2 per cent. And nearly three-quarters of all non-poor households had food ration (subsidised food) cards, while nearly a third of all the money being spent on food subsidies was being lost in what are called euphemistically 'leakages'. This was clearly a dysfunctional, regressive system. Yet it was calculated that removing the food subsidies without doing something to rectify the adverse effect, the poverty rate would rise by 9 percentage points.

So, the Egyptian government working under the guidance of the World Bank set out to phase out fuel and food subsidies while compensating the population by a complex mix of social policies that included free health insurance for the poor, improvements in basic social services in low-income villages, more targeted food subsidies and cash transfers.

This combination was almost certainly excessively complex, and looked suspiciously like a plan to reduce public spending, since only 15 per cent of the amount that had been spent on the fuel and food subsidies was set aside for all of the measures. But the two cash transfer schemes launched in June 2015 are noteworthy. One was a conditional scheme, the *Takaful*, the other an unconditional one, the *Karama*.

The former is a means-tested, conditional, flat cash transfer with variable top-ups based upon the number of children in a given household and their age (up to age 18). It is designed to improve nutrition, maternal and child health and school enrolment and retention. Depending on household composition a qualifying family receives between EGP 325 (US\$ 40.5) to EGP 80 (US\$10). Compliance such as checks-ups for children and appropriate vaccinations are required, as well as proof of school enrolment and a minimum attendance rate of 80 per cent for qualifying children. The *Karama* is an unconditional categorical cash transfer aimed at those over the age of 65 and the disabled deemed unable to work, ranging from 350 (US\$ 43.5) to EGP 1,050 (US\$ 131) per household.



Other countries that have replaced fuel subsidies are Indonesia and Mexico, in each case where the fuel subsidies had been shown to be highly regressive. In the Indonesian case, as discussed in section 10, was a temporary unconditional cash transfer scheme designed explicitly to compensate for the loss of the fuel subsidy. Unfortunately, the compensation was much less than the value of the lost subsidy, had the usual targeting failures, and only lasted for a short period. Much the same took place in Mexico.

In any case, in addition to fuel subsidies another potential source of funding of a basic income is food subsidies. These remain pervasive in developing countries, and are almost as irrational as fuel subsidies. They are premised on the presumption that the poor lack food. But often the subsidised food does not reach the intended beneficiaries and when it does has dubious nutritional value.

For instance, the Indian Government has estimated that government in recent years has been spending \$21 billion every year on food subsidies. But 54 per cent of the subsidised wheat, 48 per cent of subsidised sugar and 15 per cent of subsidised rice is lost to what are called 'leakages'.

As found in surveys and basic income pilots in two Indian states, much of what does reach villagers is inedible, often deliberately made so by shady middlemen adulterating bags of rice and wheat with stones instead. Converting the subsidies into basic incomes would be welfare-enhancing, improve diets and choice of sources of food and give better incentives to local farmers to increase production. The only excuse for the prolonged use of such subsidies is the lack of the means to distribute cash instead. With modern digitalisation, that excuse has gone.

In short, if fuel and food subsidies were phased out, a basic income system is eminently affordable. Take India as a prime example. Suppose one were to set 500 Rupees per month per person (inflation indexed), with half that amount paid to each child under the age of 14, paid to the mother or surrogate mother. This would mean a basic be about 40 per cent of subsistence.

The estimated cost would be about 8% of GDP. That could be paid by abolishing all non-merit good subsidies, worth over 8% of GDP, and adding 'revenues foregone' through the existing regressive tax holidays and tax exemptions as allowed to the relatively affluent as of early 2017, which are worth about 6% of GDP. One estimate is that if just the worst of the existing subsidies were removed, a universal basic income system would cost just 3.5 per cent of GDP.

Another approach, or a complementary one, would be to set up one or more national capital funds based on levying rental income from the use of mineral resources and

so-called intellectual property. A campaign to do this is ongoing in the Indian State of Goa, whose mineral wealth has been extracted by private mining companies, leaving the citizens of the state with very little gain. If the campaign succeeds, the objective is to establish a permanent minerals-based fund from which to pay out basic incomes to everybody.

Beyond the re-allocation of existing public expenditure (e.g. subsidies) and establishing sovereign wealth funds as we argue above there are other financing options too. Ortiz has argued that funding for social protection could also be drawn from a range of mechanisms either currently under-utilized or not utilized could be deployed. This is also true for basic incomes.

These options include: increasing tax revenues (i.e. property, inheritance and corporate taxes); increasing contributions; lobbying for increased aid and transfers (North–South and South–South); fighting illicit financial flows; tapping into fiscal and financial exchange reserves; restructuring debt; and adopting a more accommodative macroeconomic framework (e.g. tolerating some inflation or fiscal debt).

This argument represents an important political-philosophical intervention in that it emphasized that there is a need to foreground and affirm a feasibility rationale (in terms of financing basic income) that does not lie on the exclusive terrain of neoliberal/*status quo* rationality. It counters the view which reasons that basic income is not affordable.

This is also important as it illuminates that “what is possible” is ultimately a social construct, and helps develop a discourse that liberates thinking on basic income from the existing and arbitrary constraints of orthodox economic rationality.

## 10. Purging the Resource Curse, or ‘Dutch Disease’

One of saddest ironies about developing countries (and some developed ones as well) that possess natural resources with high income potential is that they have often floundered into political tyranny, where a despot monopolises the income, or into almost ceaseless civil strife. In some cases, they have also suffered from what is generally known as the Dutch disease, due to the fact that when natural gas was discovered in The Netherlands, it drove up the Dutch currency’s exchange rate, which resulted in the decimation of Dutch manufacturing, through loss of exports and the influx of cheaper manufactured goods from abroad.

One proposal has been that the way to defuse the threat of political conflict and strife is to share the resource wealth across the country. The standard way of doing this

has been to transfer part of the earnings to local area governments, and in particular to the area where production of the natural resource is centred, be it oil, diamonds or other minerals. In some cases, this fiscal devolution route has limited the conflict, if the amount transferred is large enough, and in others it has triggered it by giving local dissidents the means to pay for insurrection.

It turns out that the optimum way to defuse or prevent potential conflict is through paying direct cash transfers to everybody as individuals, as a basic income in effect. Devarajan and Giugale argued that direct dividend payments may increase both private consumption and the provision of public goods by fostering citizens' scrutiny of government's expenditures. This is also argued in the "Oil-to-cash initiative" of the Centre for Global Development. A complementary view is that direct transfers as basic incomes make it much more difficult for secessionist movements or local political parties to appropriate the resources.

A contemporary example is the public campaign in the Indian State of Goa, blessed with substantial minerals. The campaign is based on the claim that the mining of the minerals has been privatised and in effect converted into windfall revenues for mining companies, whereas the minerals should have been seen as a vital and valuable part of the commons, and as an asset. The campaign is having some considerable political success.

## **11. Basic Income in Response to Humanitarian Disasters**

The last ten years or so have seen a big expansion in the use of cash transfers to help refugees and survivors of natural or man-made disasters. In the immediate aftermath of such disasters, food, water, shelter and medicine are obviously priorities. But once that phase has passed, enabling people to recover and re-establish their economic activities and rebuild their communities is best achieved by giving them the means to help themselves.

The world responded with great generosity after the Indian Ocean tsunami in December 2004, which killed over 230,000 people and laid waste to coastal communities in 14 countries. Large amounts of money were mobilised for aid, and many NGOs sent teams to help. One of us, who was working on projects in Sri Lanka at the time, saw not just the devastation but how NGOs were literally competing to provide assistance.

The generosity and good will were genuine. But often the assistance was not what the communities wanted or needed. Providing everybody in the tsunami-affected communities with basic income cash transfers would have given them more choice on

how to move forward with their lives, instead of being showered with goods that they did not want or had no longer-term use for.

Similarly, in the aftermath of the Iraq war in 2003, a guaranteed basic income provided by the 'international community' for, say, three years, might have avoided much of the chaos and bloodshed that followed, giving Iraqis a stake in the reconstruction of their society and helping to build communities more resilient to the sirens of extremism. A basic income might also have helped after the US invasion of Afghanistan in 2001, providing a material reason for the population to support political change.

In October 2016, the UN High Commissioner for Refugees said:

*'The use of cash-based assistance has been a real game changer in the way we help refugees and we have now decided to make it a worldwide policy and expand it to all our operations, where feasible...Refugees know best what they need. The broader use of cash-based assistance means that many more will be able to decide how to manage their family's budget. This will help them lead more dignified and normal lives.'*

Another more pragmatic advantage of such a policy is that it would help to reduce the pressure on people to migrate in distress and desperation. And it would reduce the cost and inefficiencies inherent in other forms of foreign aid.

Support for a basic income in the aftermath of disasters has come from influential voices elsewhere too. Of the twelve recommendations on cash programming in humanitarian contexts, the High-Level Panel on Humanitarian Cash Transfers' first recommendation was to *give more* unconditional cash transfers. While cash alone is not the panacea in humanitarian contexts, it could be an integral part of stabilization, recovery, and building up resilience to future shocks. The scope for basic incomes in such circumstances is huge. In 2014, approximately \$1.2–\$1.5 billion of a total expenditure of \$25 billion in humanitarian contexts, assumed the form of cash- or 5 to 6 per cent.

The panel argued that the freedom-enhancing aspect of a basic income approach is critical: 'Rather than having aid agencies assess and decide what people most need, cash enables people to make their own choices, so greatly increasing its value. This reinforces the Panel's view that unconditional cash transfers should be used wherever possible in preference to vouchers or conditional transfers.' The Panel argued that unconditionality showed respect for the dignity and intelligence of affected populations to know what is best in terms of prioritising their needs, rather than predetermining that which people can and cannot purchase.

In Lebanon, host to well over a million Syrian refugees, the UN Refugee Agency (UNHCR) decided to use its limited 'winterisation' funds to pay cash transfers to vulnerable

families living above 500 metres altitude. These were unconditional, although recipients were told they were intended for buying heating supplies. Recipient families were then compared with a control group living just below 500 metres. The researchers found that cash assistance did lead to increased spending on fuel supplies, but also boosted school enrolment, reduced child labour and increased food security.

The basic income increased mutual support between beneficiaries and others in the community, reduced tension within recipient families and improved relationships with the host community. There were also significant multiplier effects, with each dollar of cash assistance generating more than \$2 for the Lebanese economy, most of which was spent locally.

The world is facing one of the worst humanitarian crises in history, with multiple conflict flash points, and the prospect of even more forced displacement and migration induced by extreme climatic events. In that context, a basic income should be considered as part of a humanitarian strategic response. It has been proposed as part of a strategy to reduce economic and social tensions in the European Union, where political trends are worrying. How so much more urgent is the need for a coherent consolidated strategy in regions afflicted by ecological shocks and civil strife. It could be shaped to be part of an inter-regional approach that tries to bridge the putative 'humanitarian-development divide'.

## 12. Concluding reflections

The state of debates on cash transfers as development policy, and basic income in particular, is at a fascinating and fertile stage. At around the time this paper was being written, the parliament of Mexico City issued its new constitution committing it to introducing a basic income.

Shortly afterwards, the Finance Minister of the Indian State of Jammu and Kashmir issued his budget, in January 2017, announcing his intention to phase in a basic income; it may be targeted but his rationale was clear. The Federal Government was contemplating doing so at national level, and issued its annual Economic Report, tabled alongside the Budget at the end of January, 2017, in which a special chapter discussed the pros and cons of a basic income.

There may be a long way to go, but the very fact that a central government of the biggest country in the world is considering it testifies to a new legitimacy. The Indian Finance Minister shortly afterwards stated that within a year more piloting of a basic income would be undertaken.

The momentum behind basic income continues to gather pace and grow exponentially elsewhere too, with a significant national pilot in Finland organised by its national social insurance institution KELA, currently underway. Pilots in Utrecht and Ontario are afoot, and there has been significant deliberative consideration of the proposal with the national (failed) referendum on the adoption of a basic income in Switzerland in 2016.

The scholarly debates over the past two decades have settled some issues, raised others and left a few in a state of unresolved controversy. Conditionality has had a relatively 'easy ride', partly one suspects because economists have been fascinated by the intellectual challenge of doing sophisticated econometrics on fancy pilot designs. But conditionality ultimately is unacceptable on moral grounds; it is paternalistic and erodes personal freedom. It is not acceptable for economists involving themselves in conditional policies to raise their hands metaphorically and say that the moral and ethical issues are not their concern.

Targeting is surely discredited beyond redemption. All forms of targeting have been found to be costly, inefficient, inequitable, usually regressive and subject to stigma and high levels of exclusion and inclusion errors, among their other drawbacks. Universalistic schemes have been shown to be more effective in reducing poverty and inequality, and more potentially transformative.

In general, recognising that cash transfers can also build resilience to shocks of vulnerable individuals and communities, by improving the health and nutritional status of children, and connecting families to government services and community support services in stronger ways, they have become central to development policy. But universal schemes do all of this more effectively than targeted, conditional schemes.

Basic income as a policy must be integrated more systematically in strategies to respond to natural disasters, economic crises and the aftermath of wars and incidents of civil strife. There has been real progress in this direction. There is now almost a consensus that this is the way to accelerate recovery from the almost-daily horrors that afflict the 21<sup>st</sup> century.

Finally, it is clear from a review of the many evaluation studies and pilot designs that certain topics have received far more attention than others. Thus, understandably, we know much more about the impact on income poverty, and also on the links to nutrition, health and schooling, than on more intangible effects such as freedom. There has also been less attention to those with disabilities, and to vulnerable ethnic minorities, than to women with children. What evidence there is on all these issues and groups is remarkably clear. Universalistic cash transfer schemes work.

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