

IS DEMOCRACY A LOGICAL CONCOMITANT OF MICROFINANCE?  
A THEORETICAL REVIEW OF THE MICROFINANCE ARGUMENT

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IS DEMOCRACY A LOGICAL CONCOMITANT OF MICROFINANCE?

A THEORETICAL REVIEW OF THE MICROFINANCE ARGUMENT

This thesis makes a theoretical review of the microfinance argument, which claims that microfinance would be accompanied with democratization or consolidation of democracy. This thesis firstly analyzes the theory of modern microfinance, especially its propensity of converting borrowers into modern citizens. Secondly, this thesis analyzes five major theories supporting the microfinance argument: (a) modernization and economic development, (b) economic fairness, (c) gender justice, (d) social capital, and (e) civil society. In addition, this thesis reviews critical perspectives of these five theories and makes a general discussion. Finally, this thesis concludes the reasonableness and limitation of the microfinance argument.

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### **List of Abbreviations**

BRAC	Bangladesh Rural Advancement Committee
CSD	Centre for Self-help Development
G1	classical mode of Grameen Bank / Grameen Classic
G2	Grameen II
GB	Grameen Bank
GNP	gross national product
HDI	Human Development Initiatives Nigeria
MFI	microfinance institution
NGO	non-governmental organization
NPO	non-profit organization
WWF	Working Women's Forum

## **Introduction**

Since the 1990s, microfinance has been highly appreciated by researchers, and well adopted by international organizations, non-profit organizations (hereafter NPOs), and governments, as a democracy-facilitating strategy. Some researchers therefore asserted that the collateral-free and group-based microfinance constitutes a vital source of citizenship and democratic education for participatory and deliberative democracy; this belief could be named the microfinance argument. The main objective of this thesis is to make a theoretical review of this microfinance argument, to dialectically analyze why and how this microfinance argument could possibly be sustainable, and finally to provide a feasible framework of theory for future empirical researchers of democratic development.

### **The Microfinance Argument**

Grameen Bank (hereafter GB), a Nobel Peace Prize-winning microfinance institution (hereafter MFI) and community development bank founded in Bangladesh, established a successful mode of microloans to the most impoverished people having no reliable credit history, trustworthy guarantor, nor valuable collateral. By using peer pressure within a small group composed of borrowers, GB created a workable mode of group lending to ensure borrowers' repayment and their in-group discipline, and founded the modern prototype of microfinance.<sup>1</sup>

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1 This thesis is aware of the fact that there are multiple modes of microfinance, and Grameen mode is only one of them. However, considering that the microfinance movement should not be understood as just a member-based financial mutual-help service, but rather an integration of financial inclusion and political socialization, this thesis uses the term of microfinance in reference to GB or Grameen replications.



Grameen-like modern microfinance could usually be identified as a self-help group: It not only exhibits a high degree of coherence and strong common interests among members but also has a democratic structure of organization and adopts democratic process to deal with the borrower group-relevant affairs (Ledgerwood 2013, 105–6). It refers to a decentralized organizational structure, a field-based delivery system, and a transparent management culture (Islam, Mohajan, and Datta 2012, 83–84), and provides members and staff an efficient democratic training of self-governance. Most MFIs adopt democratic processes to help members self-manage (Dowla and Barua 2006, 28); borrowers elect their group leaders and representative delegates (Hassan and Renteria-Guerrero 1997, 1504–5; Rouf 2011a, 124). This democracy-training philosophy is broadly adopted by Grameen replications around the world (Cheston and Kuhn 2002, 16–17; Counts and Meriwether 2008, 9; Gibbons and Meehan 1999, 167; Hassan 2002, 213; Ledgerwood 2013, 85; Quinones and Seibel 2000, 426; Sanyal 2009, 537; Servon 1992, 149). Almost all group lending programs' organizational decisions are decided by borrowers themselves through democratic procedures rather than by staff of NPOs (Hung 2006, 81).

### **The Democratic Mechanism of Microfinance**

Some researchers assert that the collateral-free and group-based microfinance constitutes a vital source of citizenship and democratic education for participatory and deliberative democracy; this belief could be named the microfinance argument. It is believed that microfinance will facilitate democratization or consolidation of democracy; all of the skills delivered by MFIs are necessary for borrowers to improve their sense of political efficacy and democratic engagement, and increase the sense of commonality among the marginalized poor (Rouf 2011a, 1). That is the reason why microfinance could be theoretically related to democracy.

Technically, most MFIs have not directly stepped into borrowers' political participation in the formal democratic process. After all, MFIs' major objective is to provide financial services rather than political interests. However, through microfinance, borrowers might have gradually increased the investment in their own community life (Larance 1998, 29–30). Financially, microfinance empowers the poor to improve their own economic conditions in an environmentally sound and sustainable manner (Auwal 1996, 28–29). Likewise, microfinance also socially empowers the poor to be more aware of their own situations and thus to be politically active. As a result, borrowers finally dare to leave their houses to attend social gatherings and participate in political activities, acting as “included” modern citizens (Hassan 2002, 213). In this sense, microfinance substantially facilitates not only the economic but also social and political empowerment of borrowers through miscellaneous financial and welfare services.

In addition, microfinance is able to facilitate borrowers' democratization of finance by strengthening their financial literacy (Erturk et al. 2007, 559). In the modern world, financial knowledge and management capabilities are more than necessary for global citizens. Higher economic knowledge and financial skills are usually related to more efficient productivity, more free time, and therefore higher affordability and willingness to participate in public life. Conversely, modern citizens with low financial skills and poorer efficiency of labor might be excluded from the formal democratic process because they need to spend more time on making a living and are less willing to participate in the democratic process. Moreover, most modern public affairs involve complicated economic issues. In that case, modern citizens need more economic and financial knowledge to help them vote intelligently (Damon 1998, 625). With microfinance's help, poor people have

gradually been re-included into the financial and economic sector, which results in the democratization of finance and therefore political democratization (Robinson 2005, 11).

### **Evidence for the Microfinance Argument**

With microfinance's help, developing countries are more likely to carry out their constitutional democracy. Most developing countries only have nominal democracy and an unwieldy state-bureaucracy. It is quite common for developing countries that most political power is monopolized by capitalists and religious elites. Even though they might have democratic constitution and regular elections, most people in developing countries have relatively little power and are less capable of taking civil and political actions. In that case, microfinance provides the poor a means of building up citizenship, directing social changes, and establishing a voice in public affairs (White 1991, 15).

As a result, microfinance helped developing countries make great progress in the formal democratic process. For example, the voter turnout in Bangladesh in 1996 broke the past record due to increased female voters, which is commonly attributed to GB's persistent effort at providing borrowers' democratic training (Yunus and Jolis 2003, 196). Likewise, the rate of democratic participation for Grameen members and their spouses was 100 percent in 1996. In the next year, more than 2,000 Grameen members got elected in local elections (Yunus 2002, para. 4–5). In Bangladesh's local election of 2009, about one-quarter of the total seats were won by Grameen members and their families; the number of female Grameen members serving as sub-district councilors increased from 1,572 in 1997 to 1,950 in 2003 (Rouf 2011a, 127). Similar cases have been found by researchers while observing Grameen replications around the world. As a study shows, the longer a female borrower belongs to Bangladesh Rural Advancement Committee (BRAC), a microfinance NPO in Bangladesh, the more likely she will be politically em-

powered (Hashemi, Schuler, and Riley 1996, 641). BRAC has a strong effect on female borrowers' participation in political campaigns and public protests: more and more BRAC members stand for local election as independent candidates (Hashemi, Schuler, and Riley 1996, 639). Likewise, over 89 percent of the members of Working Women's Forum (WWF), a women-centered MFI in southern India, had taken up civic actions against oppression in their neighborhoods (Working Women's Forum 2000, 22). In the Philippines, female borrowers of the Opportunity Microfinance Bank zealously used their leadership skills and confidence cultivated in the borrower group to run for local public offices (Bayulgen 2008, 537–38). In Latin America, a former leader of the borrower group of a local Honduran MFI actively used her experience and confidence to run for mayor of a small town. Members of the Trust Banks of AGAPE in Colombia helped members organize protest marches for community development (Cheston and Kuhn 2002, 24). In Russia, female borrowers of the Opportunity International Network (now FORA Fund) organized themselves to campaign for democracy (Littlefield, Hashemi, and Morduch 2003, 8). All of these examples suggest that microfinance might be able to contribute to the effort of awakening the poor's political awareness (Hadenius and Ugglá 1996, 1636) and facilitating their political empowerment and democratization. Though democratic transitions hardly occur through a "single" or "direct" process but rather through multiple paths defined by miscellaneous factors (Barry 2012, 125–27), proponents of the microfinance argument still see the impact of microfinance on democracy.

### **Theories Supporting the Microfinance Argument**

This thesis focuses on five major theories which imply or support the microfinance argument: (a) the democratic theory of modernization and economic development, (b) the democratic theory of economic fairness, (c) the democratic theory of gender justice, (d)

the democratic theory of social capital, and (e) the democratic theory of civil society. Almost all of these five theories make their arguments via a two-step process: In the first step, all of these theories argue that their factors, such as economic development, economic fairness, gender justice, social capital, or civil society, are highly co-related (positively or negatively) to democratization or consolidation of democracy. In the second step, these theories argue that microfinance is highly co-related (positively or negatively) to those variables as well. As a result, it would be accordingly inferred that microfinance is highly co-related to democratization or consolidation of democracy, i.e. the microfinance argument.

According to the microfinance argument, microfinance is able to awaken the poor's political awareness, facilitate their political empowerment, and therefore is likely to be associated with democratization or consolidation of democracy (See Barry 2012; Hadenius and Ugglå 1996). However, none of these theories really explain the potential relationship or co-relationship between microfinance and democracy. Moreover, few, if any, researchers mentioned theoretical inconsistencies among these five theories. For that reason, the major objective of this thesis is to bridge this gap by making a comprehensive theoretical review and analysis in order to obtain the "whole picture" of the microfinance argument.

## **Methodology**

By definition, this thesis is a literature-based theoretical analysis. On one hand, this thesis adopts the method of Documentary Analysis (See Ritchie 2003) to deal with first-hand sources and obtain relevant knowledge by reviewing various documentary materials, such as MFI's financial reports, internal statistical data, official guidelines, and policy statements. On the other hand, this thesis uses the method of Between-Study Literature

Analysis (Onwuegbuzie, Leech, and Collins 2012, 5–6) to deal with second-hand sources and obtain relevant knowledge by scrutinizing miscellaneous academic works, such as journal articles, monographs, technical reports, working papers, and meeting articles. By putting all these sources and materials together into a theoretical framework, this thesis theoretically analyzes the microfinance argument and makes a theoretical review.

### **Major Findings**

In this thesis, the typical experience of modern MFI, including GB and Grameen replications, is introduced. Based on that understanding, this thesis dialectically exams the microfinance argument by analyzing most microfinance theories, democratic theories, five major theories supporting the microfinance argument, and relevant critiques. It is not intended by this thesis to demonstrate the causal relationship between microfinance and democracy; this thesis only focuses on theoretically explaining the reason why co-relationship might exist between these two variables. By reviewing and analyzing the supporting theories of the microfinance argument and relevant critiques, this thesis clarifies this argument's reasonability and the plausibility. In addition, by linking various indirect explanations of the microfinance argument to a more comprehensive theoretical understanding, this thesis bridges the theoretical gap and rephrases the microfinance argument. It is asserted by this thesis that the microfinance argument is theoretically reasonable, although it might face some fierce critiques or exceptional cases. However, the impact of microfinance on democratization or consolidation of democracy is relatively indirect and chronic, and it would be by nature difficult for researchers to precisely measure its effect. With this caveat and the contribution of this thesis, future researchers of democratic development, will have more solid ground to evaluate the democratic contribution of microfinance while considering its political benefits.

## **Structure of This Thesis**

This thesis consists of five parts: The first part introduces the philosophy and theories of modern MFI, especially GB and Grameen replications around the world in Chapter 1. The second part reviews the most acceptable definitions of democracy and their theoretical pillars in Chapter 2. Third part analyzes five major theories supporting the microfinance argument in Chapters 3 and 4. The fourth part introduces theoretical critiques of the five major theories supporting the microfinance argument in Chapter 5, and makes a general discussion of the microfinance argument in Chapter 6. Finally, the Conclusion reiterates the major findings of this thesis and rephrases the microfinance argument into a more accurate and exquisite version.

## **1. Microfinance as a Civil Society Organization:**

### **From Borrower Members to Citizens**

In this chapter, a brief history is introduced about the Grameen mode of modern microfinance and how it developed. This chapter, in addition, discusses how the Grameen mode of microfinance works, analyzes its ideas and theories, and unveils its core mission of modernization and democratic civilization. Due to this cause of democratization, microfinance is accordingly expected to forerun the democratic reform or deepen the democratic development while providing a financial outlet for the poor in most developing countries.

### **Grameen Bank: The Prototype of Modern Microfinance**

The prototype of the modern MFI was created by GB. It revised the old self-help/mutual-help group lending system and introduced pro-capitalistic internal incentives to borrowers so that a new self-sustainable and replicable mode of microfinance was made. In addition, based on the spirit of self-employment, being self-sustaining, and self-reliance, GB also created a new strategy of poverty alleviation. Today, GB has 8.6 million members and 2,567 branches all around the world, and has cumulatively disbursed USD 15.08 billion since its inception (See Grameen Bank 2014). Its branches, cooperative partners, and inspired replications have spread from Bangladesh to the whole world.

The classical mode of GB (Grameen Classic, hereafter G1) was characterized by its nature of group lending. By group lending, GB successfully provided a loan service to those who have no (or only bad) credit history, no guarantor, or no collateral or warranty. The group lending system organized borrowers as a small group and utilized peer pressure as the social collateral to ensure borrowers' punctual repayment. This joint liability



system relied on social sanction (Armendáriz 1999, 81), from refusal of re-finance to ostracism (Ito 2003, 325) or even the use of physical force by peers (Armendáriz and Morduch 2000, 404). However, after its 24 years of practice (See Yunus 2013), GB adopted a new system, Grameen II (hereafter G2), in order to deal with the precariousness of the poor more flexibly (Dowla and Barua 2006, 93). It discarded the negative pressure of social sanctions in the group lending system and tried to induce borrowers' internal initiative. By fulfilling borrowers' various needs and invoking their spontaneous and self-interested incentive for higher income, G2 made borrowers more active in their microenterprise so that they would be more willing to repay their installments on time in order to retain their opportunities of refinancing. As a result, GB made its recovery rate of bad debt from zero-point-one-two percent in 1999 to 12.95 percent in 2005 (See Grameen Bank 2013f). This borrower-oriented strategy of microfinance is well adopted by Grameen replications around the world, especially the ghetto areas in well-developed countries. Though still having different policies and regulations, most Grameen replications share similar spirits and essential values with GB: (a) to help borrowers accumulate and enlarge their capital; (b) to consolidate borrowers' mutual trust and in-group identity; (c) to provide borrowers and their families financial benefits and mutual welfare as incentives; and (d) to develop borrowers' out-group engagement.

### **Enlarging and Accumulating Borrowers' Capitals**

The main goal of microfinance is to help borrowers enlarge and accumulate their capitals, including financial capital and social capital. In order to bring borrowers positive cash flow, MFIs provide them financial capital and help them invest it into productive businesses, mostly microenterprises. With the help of positive cash flow, borrowers are

able to escape from double oppression, the predicament mutually worsened by undercapitalization and poverty. On the contrary, borrowers' financial capital and social capital mutually improve each other. In order to start this beneficial cycle of dual capital, MFIs need to be convinced by borrowers' creditworthiness in order to lower MFIs' credit risk (Hung 2002, 238). In the group lending system, borrowers must join a voluntary borrower group in order to obtain their loan. This group is typically composed of five persons who share similar economic strengths and social characteristics (Rahman 1996, 211). The group size is intentionally designed to be small (Mondal and Tune 1993, 226); as a study shows, members of small groups will cooperate more than will members of large groups (See J. A. Wagner 1995). All group members have the compulsory duty to attend weekly meetings and make repayments regularly (S. R. Khandker, Khalily, and Khan 1995, 11). In addition, they govern themselves by self-electing leaders and making decisions through democratic processes. Every five to eight groups are tied together as a center, and democratic procedures are adopted by the whole Grameen hierarchy to self-organize (Dowla and Barua 2006, 156; Hassan 2002, 230).

For MFIs, the key to group lending is the peer or social pressures, which act as borrowers' social collateral: borrowers use their reputation and trustworthiness to take the place of the traditional physical or financial collateral (van Bastelaer 2000, 1). Since borrower groups are often composed of self-selected members who already have social connections to each other, borrowers can easily screen out risky members or those untrustworthy to repay loans, which covers the economic cost of negligence. As a study shows, identifiability in a social group is positively co-related with cooperation of members (J. A. Wagner 1995, 167). With the help of social pressure, borrowers do keep a sharp eye on

transaction costs involved in enforcing payment (van den Brink and Chavas 1997, 752–53). Once borrowers feel confident in trusting others, they will feel confident trusting themselves through other borrowers' trust. Through the mechanism that only those trustworthy ones are allowed to obtain new debts and bigger loans, borrowers are willing to voluntarily discipline themselves in order to demonstrate their trustworthiness (Karlan, Harigaya, and Nadel 2009, 237).

Once borrowers are familiar with the discipline and the group life, they will easily turn their social capital into financial capital and reproduce more social capital in turn. Since social trust and social pressure are the only things the poor can count on in order to be self-reliant, one of the major missions of MFIs is undoubtedly to strengthen the trustworthiness of borrowers. MFIs utilize peer pressure and joint liability of solidarity groups as a special type of risk management (Quinones and Seibel 2000, 425). There are three levels of social pressure in the microfinance system: First, the grass-roots group chairperson or MFI staff personally visit those borrowers who have missed regular meetings (and repayments). In addition, members publicly scold those borrowers who fall behind in their own repayments (Hashemi, Schuler, and Riley 1996, 649). Finally, by hosting regular meetings and workshops, MFIs invite members to audit all transactions. This transparency of operation helps MFIs win borrowers' trust. In return, MFIs can use their credibility and power to promote services such as education of literacy, of productive skills, and of sanitary knowledge for the modern life of members.

### **Consolidating In-Group Identity**

In order to maximize members' social capital, most MFIs prefer to invest their resources in the most vulnerable and neediest targets in society, because they are usually

those who are most willing to preserve their trustworthiness as well. While some MFIs, such as the Landless People's Development Fund, focus on the proletariat or the landless in society, others target women, minorities, immigrants, and the disabled, or even some more moderate-income individuals with job-skills and experience (Keating, Rasmussen, and Rishi 2010, 158–59). MFIs usually use socio-economic features such as sources of income, demography, occupational pattern, land-ownership, market-accessibility, or literacy as the tool of identifying the neediest group. In some extreme cases, MFI's effective targeting even yields the impression that participation in microfinance makes the poor poorer (Morduch 1999a, 1599).

Due to their occupational patterns, which easily form groups, poor women are usually MFIs' best target (Rahman 1996, 211). For four reasons, MFIs usually prefer female members: The first reason refers to the fact of gender inequality. Females are usually the poorest or the most suffering group in society, which makes them the “worst” borrowers for traditional financial agencies, but those who need the financial capital most and those who are most willing to prove their trustworthiness. The second reason is related to the nature of female's reliability. Female members usually attend regular meetings more frequently and repay their installments more steadily than males (See Armendáriz and Morduch 2000, 417; S. R. Khandker 2012, 21; S. R. Khandker, Khalily, and Khan 1995, 18). The third reason refers to the gender-based pattern of loan utilization. While male borrowers tend to invest in “big” projects, most female borrowers utilized their loans on pragmatic plans in the primary economic sector (Hossain 1988, 49–50), which have lower risks and are relatively easy for new, self-employed microentrepreneurs. The final reason refers to the gender difference of social essence. A female-based group is easier to

mobilize and requires less effort to consolidate. In contrast, male members are less willing to trade off their obedience to the collective norms against the opportunity of microfinance, especially when most males still have some socio-economic edge over females (See Hossain 1988, 62 table 33). As a result, most MFIs focus on female borrowers by providing the means for productive self-employment and inviting them to re-participate in the “mainstream” economic and political processes of society (See United Nations 2006).

In order to make borrowers familiar with discipline codes of conduct and some other necessary modern knowledge, GB outlined the “16 Decisions” (See Grameen Bank 2013a), which embody GB’s overall objective of social development (United States Agency for International Development 1995, para. 1). Likewise, other MFIs also use similar discipline codes to educate members (See Develtere and Huybrechts 2002, 3; Shahidur R. Khandker 1998, 26–27 table 2.3). Through discipline codes, MFIs raise borrowers’ conscientiousness and knowledge, consolidate their in-group identity, improve their civic engagement, forge their sense of citizenship, and, eventually, strengthen their commitment to MFIs (Rahman and Samad 1993, 182).

In order to emancipate borrowers’ productivity, MFIs utilize rituals to “help” members become familiar with their norms. For example, Grameen members must salute each other and sit on the floor in specific rows at regular meetings (Hashemi, Schuler, and Riley 1996, 649). In addition, GB asks members to collectively recite the “16 Decisions” before every regular meeting or workshop begins (See Ferraro 2000). Sometimes it even asks members to parade and do physical drills while chanting the discipline codes (Hossain 1988, 27). Through all these rituals, MFIs intentionally impose the discipline codes upon

members. After all, “Credit without strict discipline is nothing but charity. Charity does not help overcome poverty; it can only offer temporary relief” (Yunus 1998, 55). All these ritualized discipline codes create a new way of thinking, fighting against the traditional and conservative values and gender roles (Develtere and Huybrechts 2005, 184).

Through group lending, MFIs allow borrowers to be their own guarantors (Yunus 2008, para. 7). What MFIs count on is the trust between MFIs and borrowers, and more importantly, the trust among all borrowers. Trust not only guarantees borrowers’ repayment but also consolidates members. This social collateral shapes a Durkheimian relation of “non-contractual elements of contract” (Woolcock 1998a, 156) between MFIs and borrowers. Likewise, trust and social connections among members have a significant effect that lowers the cost of information-gathering. Since both cultural similarity and geographic concentration can lead to improved group lending outcomes (Karlan 2007, 78–79), as an observation in Peru shows, MFIs also need to invest resources in building a better communication network among borrowers to encourage them to be socially interconnected. For that reason, most MFIs prefer to focus on homogeneous members who have already shared some level of social connections and bindings.

However, as a laboratory experiment shows, it is far less than enough to make the peer monitoring mechanism work well in the case that MFIs only rely on strong social ties among borrowers (Cason, Gangadharan, and Maitra 2012, 207). Since the cost of peer monitoring could be high while facing the household-based atomistic nature of rural economies, what MFIs need is to build adequate infrastructure among borrowers in order to de-atomize borrowers, i.e. a strong bonding among members. Once borrowers are psychologically and materially connected or interdependent through emotional bonds, tradi-

tions, and social groups, their preferences of decision-making will be more likely to be based on loyalties and trust (Stone 2002, 10). Due to that reason, modern MFIs use most of their resources to consolidate borrowers in order to forge a strong in-group identity and feeling of belonging.

### **Providing Mutual Benefit and Welfare as Incentives**

Due to the dependence on inner coherence of borrowers' social capital, G1 suffered an unstable mechanism that kept members in the microfinance system. After 1995, more and more borrowers dropped out of membership because their microenterprise did not work out as expected. The tremendous flood that hit Bangladesh in 1998 acted as the last straw; though GB provided borrowers fresh interest-free loans to maintain their living conditions and rebuild their homes, many of them still felt burdened by the accumulated loans, and chose to avoid regular meetings or cut their contact with other group members. As a result, GB made up its mind to adopt the G2 system. It not only readjusted the structure of its internal capital flow, but also strengthened its role as a provider of mutual welfare services to members. With the help of various beneficial services, MFIs provide borrowers a motivation to voluntarily stay in the microfinance system (Rahman and Islam 1993, 57–59). As a result, GB successfully solved its crisis of internal trust brought by natural disasters and reshaped the role of MFI.

Group Fund. Before 2000, the G1 system asked borrowers to deposit a weekly contribution and an extra five percent of their loan amount into a group account called the Group Fund, which was rewarded with interest at eight-point-five percent annually (Hossain 1988, 27) and acted as a form of insurance (Hassan and Renteria-Guerrero 1997, 1500). This account was managed by the borrower group itself consensually for emer-

agency use. In addition, with all group members' consent, a borrower once able to make an extra interest-free loan from the Group Fund if in needy circumstances (Dowla and Alamgir 2003, 973), although they still needed to deposit an extra five percent of this new loan amount into the Group Fund (S. R. Khandker, Khalily, and Khan 1995, 30). However, this Group Fund brought borrowers a heavy burden of interest and its compulsoriness made borrowers privately call it a "group tax" (Dowla and Barua 2006, 122). Even worse, borrowers were not entitled to claim their share of this Group Fund when they chose to leave the microfinance system (Hossain 1988, 26).

Compulsory Savings. GB under the G1 system reduced the required contribution for the Group Fund after 1991 and canceled the whole Group Fund system under the G2 system; however, GB still asks borrowers to deposit five percent as the "Compulsory Savings" (Hossain and Diaz 1997, 93). This new extra compulsory savings is comprised of two different savings accounts, both of them under borrowers' own names. Two-point-five percent of the savings is deposited in a personal savings account, opened at the beginning of the membership for the required weekly deposit by the borrower, while the other two-point-five percent is deposited in a special savings account (Rutherford, Maniruzzaman, and Sinha 2004, 9–10). Borrowers can withdraw any amount from the personal savings account at any time but cannot withdraw the special savings account until (a) maintaining the membership for more than three years, (b) having no "bridge loan" or "flexible loan" (Dowla and Barua 2006, 81–82), and (c) the balance of the special savings account meets the minimum requirement for more than three years (Yunus 2013, para. 21).



The idea of compulsory savings is well-adopted by Grameen replications around the world (See Counts and Meriwether 2008, 7; Dowla and Alamgir 2003, 973; Quinones and Seibel 2000, 426). Many MFIs use members' compulsory savings as an internal source of funding to keep their resource-mobilization and reduce their dependence on government funding, external donor, or commercial resources (Quinones and Seibel 2000, 425). However, those borrowers who lack determination or the discipline to accumulate savings may view mandatory savings merely as an additional burden (Karlan, Harigaya, and Nadel 2009, 246). For that reason, MFIs need to enhance the education of borrowers through the discipline codes or lectures. Nevertheless, some MFIs still need to find extra financial sources to subsidize borrowers in order to increase borrowers' incentive to support the compulsory savings system.

Compulsory Pension. Under the G2 system, every borrower who has a big loan (more than BDT 8,000) must contribute a monthly deposit as their pension, while it is optional if the loan amount is small (Rutherford, Maniruzzaman, and Sinha 2004, 14). Borrowers can choose different plans for the pension, under different conditions of interest reward (Counts and Meriwether 2008, 2). In each case, borrowers will receive a doubled pension fund if they join this pension system for 10 years (Rutherford, Maniruzzaman, and Sinha 2004, 14). However, if borrowers delay their deposit to the pension plan for more than four months, the pension account will turn into a regular savings account with a reduced interest rate of eight-point-five percent automatically (Dowla and Barua 2006, 73).

Emergency Fund and Life Insurance. The new pension plan introduced by the G2 system was inspired by G1's existing Emergency Fund; borrowers were obliged to de-

posit a sum equivalent to 25 percent of their loan amount as the Emergency Fund under the G1 system (Rahman 1996, 197), which was deposited in a special account and acted as insurance for member's funeral and burial expenses, death pension, disability allowance, or other unforeseen events (Hossain 1988, 27). It also offered protection for debts or liability when a member died or lost the business for *force majeure* (Hassan and Renteria-Guerrero 1997, 1500). However, just like the Group Fund, the Emergency Fund became burdensome for many borrowers. GB therefore reduced the requirement for the contributions to the Emergency Fund after 1991 (S. R. Khandker, Khalily, and Khan 1995, 11) and cancelled the whole Emergency Fund system in 1992 (Wahid 1993, 34). Under the G2 system, the Emergency Fund evolved into the Special Savings Fund, acting as a combination of default insurance and life insurance. With the help of the Special Savings Fund, borrowers will have whole coverage for their outstanding loans with the help of insurance. In addition, their families will be able to obtain the amount that was deposited if the borrower dies (Dowla and Barua 2006, 98). The Special Savings Fund even pays for borrower's funeral and burial expenses. The mandatory insurance is mutually productive for both MFIs and borrowers. On one hand, it is profitable for MFIs due to its nature of ensuring broad participation (which enables insurers to reach economies of scale) and of limiting the effect of adverse selection (which increases the accuracy of predicting insurers' future claims). On the other hand, mandatory insurance has become the reward provided by MFIs to borrowers as a loyalty incentive (Churchill 2013, 255–56).

Flexible Credit Service. Under the G2 system, GB started more flexible and borrower-oriented financial services. It adopted a new loan ceiling policy, which allows bor-

rowers having better repayment history to obtain bigger loans. Likewise, GB, under the G2 system, also set a flexible criterion of installment based on the nature and the environment of borrowers' microenterprises (Dowla and Barua 2006, 75). In addition, GB has adopted a new early-warning system. During their own probation period (first six months or 26 weeks since joining the microfinance system), borrowers can only obtain a small loans, which exactly equals to the amount of what has already been paid by the borrower. After the probation period, borrowers will be able to obtain bigger loans (Dowla and Barua 2006, 93–94). Furthermore, GB under the G2 system provides the “flexible loan” service, which allows borrowers to temporarily reduce their installment in case they have trouble repaying the debt during the “grace period” of six months or 26 weeks in each of their loan cycle (Dowla and Barua 2006, 75–76).

Housing loans. After the devastating floods of 1987 and 1988, GB under the G2 system reshaped its housing loan services in order to respond to the crisis caused by the series of natural disasters (Dowla and Barua 2006, 25; Rahman and Hasnat 1993, 87–88). Since its inception, GB has always encouraged borrowers to improve their housing conditions, maintain sanitation status, and keep a healthy and productive living environment by instilling its discipline codes in members' minds. As observations show, GB's housing loans significantly improved borrowers' living conditions; they had larger living space and better resistance to natural disasters (Hassan and Renteria-Guerrero 1997, 1512–13; Hassan 2002, 238–39; Hossain 1988, 69). Psychologically, housing loan borrowers felt more joyful and happy and had revitalized self-dignity and self-confidence (Rahman and Hasnat 1993, 77). As a result, housing loans have positive impacts on Grameen borrowers' total working hours (Hassan and Renteria-Guerrero 1997, 1514), their willingness to

seek a secondary source of income (Rahman and Hasnat 1993, 92), and, therefore, their repayment capability.

Though housing loan services are commonly provided by MFIs in various forms, the profits from this kind of business is actually limited. For example, GB earned significantly less income from its housing loan business, compared with its normal loan business (Hossain 1988, 72). This suggests that the reason why MFIs keep providing housing loan services is not for their short-term profit from the income of interest but for their long-term benefit through enhancing borrowers' identity of membership and commitment to MFIs, incentive of profit, living conditions, productivity, and repayment capability.

Public Health. Other than hosting public health lectures during borrowers' regular meetings (See Dunford 2001, 15), many MFIs set up health care centers to serve borrowers and field-level staff, in order to enhance their health and productivity. For example, GB has Kalyan (meaning "well-being"), who invests in health-related enterprises and activities (Morduch 1999b, 243) and provide primary health care services and micro health insurance services. Likewise, BRAC also provides borrowers and staff primary health care services and micro health insurance (Schurmann and Johnston 2009, 523). Due to their limited resources, some smaller MFIs choose to cooperate with large commercial insurance companies as third-party service providers (Ledgerwood 2013, 195).

All of these health-relevant services provided by MFIs help borrowers enhance their living conditions and productivity (M. M. Pitt and Khandker 1998, 986; M. M. Pitt et al. 2003, 111). In addition, MFIs' health services significantly increased their consumption habit. Borrowers expended a higher portion of resources on health care (Rahman, Wahid, and Islam 1993, 123). They also increased their demand for formal health care services,

which indirectly promoted investment in public health in rural areas (Dowla and Barua 2006, 45–46). All in all, the health services provided by MFIs significantly reduce borrowers' likelihood of falling under the poverty line and act as an informal mechanism of risk insurance (Biosca, Lenton, and Mosley 2011, 5, 17).

Members as Shareholders. The ultimate means of MFIs to attract borrowers to stay in the system is extending its ownership to members. GB, under the G2 system, allows borrowers to use their deposit in the special savings account to purchase its shares. GB did not pay shareholders dividends until 2007 (Grameen Bank 2013c, para. 1), but it now provides dividends as reward interest into member shareholders' accounts. For example, it declared 100 percent for the year 2006 and declared 30 percent as cash dividends for the year 2010 (Grameen Bank 2013b, para. 13). In 2010, about 96.71 percent of GB's shares were owned by borrowers (Grameen Bank 2013e, para. 4). It is also found that many MFIs in developing countries allow borrowers to purchase their shares (See Nelson 2013, 167).

The idea of “member-ownership” is one of the best solutions for establishing a long-term cooperation between MFIs and borrowers. In most developing countries, the government's enforcement of loan contracts is neither binding nor easily enforceable. Politicians or officials often write off small loans or remit interest payments of poor people in order to win their political support. As a result, it creates or promotes a prevalent culture of default among common people (Shahidur R. Khandker 1998, 85), which suggests that government-owned or -funded microfinance programs can hardly build their credibility and that client borrowers can hardly subject their short-term self-interests to the mutual well-being. Conversely, MFIs whose shareholders are mostly borrowers tend to pursue

long-term strategic interest. Due to their edge of trust between MFIs and borrowers and mutually among borrowers, such MFIs need not put their capital at unnecessary risk and are less likely to engage in risky activities to pursue short-term profit maximization (C. Wagner 2012, 189). Furthermore, since such MFIs' non-public ownership structure reduces their dependence on capital markets, they usually have lower national and international market exposure, and lower operational and financial leverage (Krauss and Walter 2009, 107–8). As a result, due to their strong ownership structure, such MFIs could be more resistant to fluctuation and recession (Jansson 2001, 7). In addition, due to having a clear ownership structure, a joint-stock MFI is likely to attract private capital, which is essential to increase a MFI's outreach in developing countries that lack financial resources (ECSSD Microfinance Team 2004, 16–17). It is well-observed that MFI's outreach to the poor and its viability are not only compatible but also are mutually reinforcing (Seibel and Torres 1999, 124). In order to serve difficult-to-reach borrowers, MFIs need to maintain regular contact and build a solid interconnection with borrowers (Parker and Nagarajan 2000, 3). In this sense, inviting borrowers to be the shareholders is one of the best ways to establish the mutual trust between MFIs and borrowers.

### **Developing Institutional Engagement**

In order to guarantee borrowers' repayments, MFIs need not only the consolidated social capital among borrowers, nor the internal incentives induced by benefits and welfare services, but also a more favorable external environment. As the United States Agency for International Development suggested, MFIs need a pro-capitalist and pro-democratic external environment to facilitate their development (See Nagarajan and McNulty 2004); pro-capitalist and pro-democratic ideas must take root in borrowers' minds,

in order to thoroughly change their *weltanschauung*, or worldview, and to convert them into law-abiding and cooperative modern citizens.

MFIs use various resources to encourage borrowers to recognize the existing capitalist regime and honor the rules in order to flourish in it. In return, the trust in the institutions from borrowers helps MFIs maintain the whole microfinance system. Once borrowers understand and are willing to pursue their prosperity by following market rules, they will see the others as equal transactors in the market. Meanwhile, once having knowledge and skills to participate in the democratic process of political affairs, they will know how to protect their legal rights; more importantly, they will know how to use the law and legal institutions to protect their interests and pursue profits.

Educational Loans. Most MFIs emphasize education of borrowers. They usually use regular meetings or workshops to deliver necessary knowledge or skills training. In return, this empowerment-training provided by MFIs increases their impact on borrowers by improving members' mobility and ability to make economic decisions. For example, as an observation of MFIs in Peru shows, although most borrowers complained those longer and longer regular meetings which are caused by the extra training courses MFIs provided, they still choose to stay in the microfinance system because they did gain greater knowledge and more productive skills of managing their microenterprise from their microfinance participation; the increased length of regular meetings was outweighed by the perceived benefit of the training courses provided by MFIs (Karlan, Harigaya, and Nadel 2009, 235).

Other than that, most MFIs provide various financial resources for the education of borrowers' children. Financial support of education is commonly used as the vehicle of

enhancing group identity, enforcing moral or social obligations, and facilitating the emergence of social trust (Portes 1998, 9). Likewise, almost every MFI's discipline codes emphasize the importance of children's education and their capacity to pursue further education (See Grameen Bank 2013a, para. 7; M. M. Pitt and Khandker 1998, 26–27 table 2.3). For example, GB set up a compulsory Children's Welfare Fund for the education of borrowers' children, which maintains local primary schools (MacIsaac and Wahid 1993, 198) and supports children's involvement in income earning projects (S. R. Khandker, Khalily, and Khan 1995, 30) or productive auxiliary skills (Hossain 1993, 15). In addition, GB also set up a grant program for high-school students of members<sup>2</sup> since 1999 (Dowla and Barua 2006, chap. 7; Yunus 2013, para. 47) and a higher education loan program since 1997 (Grameen Bank 2013d, para. 9). Meanwhile, GB provided flexible loans for the primary or secondary education of borrowers' children (Ledgerwood and Earne 2013, 224). Up to 2009, GB issued loans for higher education of about USD 36.95 million and helped 50,177 students obtain their post-secondary degrees (Grameen Bank 2013d, para. 4).

As a result, as an observation shows, microloan borrowers' children were more likely to go to school and their drop-out rates were much lower (Dowla and Barua 2006, 222; Littlefield, Hashemi, and Morduch 2003, 4; Shahidur R. Khandker 1998, 49); students in microloan borrowers' families usually performed better than their counterparts (Littlefield, Hashemi, and Morduch 2003, 6). MFIs' emphasis on education has changed borrowers' ideas and life. More and more borrowers see education as an asset rather than an unnecessary expenditure; a well-educated young woman could have not only a better income-earning job but also a more economically "advantageous" husband (S. Shetty 2010,

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2 GB intentionally preserves half of the opportunity for the grant for girls exclusively and opens the rest half to both girls and boys.



377). With microfinance's help, borrowers gradually encourage children to develop their education and be better citizens; most second generation of borrowers now have the skills to protest on the street, lobby for their own interests, and are capable of taking action for the rights of the marginalized poor (Rouf 2011b, 23).

Group Lending Is Not a Panacea. Joint liability or group lending is just one mechanism driving the performance of loan repayment, although it could be important, especially in early stages and for poorer clients (Armendáriz and Morduch 2000, 416). However, group lending does not necessarily work all the time (See Armendáriz and Morduch 2000, 418; Vinelli 2002, 156). One of the prerequisites of group lending is a powerful environment full of the force of social sanction (See Karlan 2007), which deeply relies on a static social network and asks no change of social structure. Once social connections shift, the mechanism of group lending will malfunction (Armendáriz and Morduch 2000, 416). Joint liability loans can only encourage borrowers' mutual insurance at the cost of excessive punishment in equilibrium. A good group lending system needs an efficient mechanism of cross-reporting among borrowers, which is costly to establish and maintain, in order to reduce the inequality of information about borrowers' repayment capacity (Rai and Sjöström 2004, 217). As a matter of fact, due to the excessiveness of the cost of joint liability, only few MFIs can fully cover the cost of group lending (Morduch 1999c, 246), and borrowers will only stay in the microfinance system while having no alternative options (Vigenina and Kritikos 2004, 174). As some empirical researchers suggested, the group lending model might be less suitable to relatively industrialized areas (Armendáriz and Morduch 2000, 403), because the cost of cross-reporting is higher and borrowers have more alternatives.

As empirical studies show, internal incentives of borrowers alone are not sufficient to sustain a microfinance system (Pickering and Mushinski 2001, 460). It calls for an institutional force providing the public goods in order to impute the cost of cross-reporting. If borrowers can honor the institution itself, both individual loans and joint liability loans deliver the efficient outcome, and *vice versa*, since the institution itself elicits a revelation of truthful information from borrowers through cross-reporting schemes (Rai and Sjöström n.d., 2). That is, a well-functional external environment in favor of the mutual trust is vital for MFIs' success. Peer pressure and group lending can only work in MFIs' early stage. Eventually, MFIs need to lead borrowers to the external regimes, which provide a superordinate value system or ideology to constrain single member's self-interested reasoning. In other words, the key to a MFI's success is to transform borrowers into modern citizens, while acting as part of the engineering of socio-economic inclusion.

Socio-Economic Inclusion. Education, one of the most focuses of the MFIs' welfare services, is commonly seen as a driver of economic recovery and social inclusion. For most welfare states, education should enable all citizens to acquire quality knowledge, skills, and competences needed for employment, inclusion, active citizenship, and personal fulfillment (European Commission n.d., para. 1). However, welfare services like education, in most developing countries, were primarily provided by the government or international NPOs, which might be biased by intentional political activism and elites' prejudices, and therefore reflect and reinforce existing social inequalities (Davis 2001, 93; Rahman and Razzaque 2000, 19). Within these vertical networks of "clientalism," individuals tend to devote their loyalty to welfare service providers rather than to their own social groups, which weakens the horizontal class solidarity among the poor (Goetz and

Gupta 1996, 86). In this sense, microfinance can help fight against social exclusion; the economic integration might result in the poor's social empowerment and increase of self-esteem and dignity (Bayulgen 2008, 531); the credit provided by MFIs becomes a means, rather than an end, of self-fulfillment (Velasco and Marconi 2004, 525).

Furthermore, MFIs need a more socially inclusive membership to enhance the internal strength of peer pressure (Schurmann and Johnston 2009, 521–22). For that reason, since 2000, GB, under the G2 system, started to accept struggling members, who are the poorest among the hardcore poor. By providing loans with a longer repayment period and smaller installments (Rutherford, Maniruzzaman, and Sinha 2004, 45), inducing in-group identity and self-esteem (Dowla and Barua 2006, 214), providing free welfare services (Rutherford, Maniruzzaman, and Sinha 2004, 45), and adopting the in-kind credit system (Dowla and Barua 2006, 208), GB's project for struggling members has successfully improved the hardcore poor's situation. Only three-point-one percent of female and about 24 percent of male struggling members did not regularly repay their installments during the worst year of 1991 (S. R. Khandker, Khalily, and Khan 1995, 59). The ultimate goal of the GB for these struggling members is to convert them from dependents to self-sustainers (Dowla and Barua 2006, 215). With microfinance's help, these struggling members can gradually find a dignified livelihood, send their children to school, bring themselves back to the microfinance system, and be socially re-included again (Rutherford, Maniruzzaman, and Sinha 2004, 45). The marginalized poor can be organized and included by the mainstream of the society, which leads them to higher levels of political awareness and participation as well (Schurmann and Johnston 2009, 521–22). Once these outsiders become active citizens, they will be empowered to participate in the political

process, call for opportunities to learn and practice autonomy, responsibility, cooperation, and creativity, and develop a sense of “rich self” (See Benn 2000). On one hand, MFIs have impacts on borrowers’ sense of “external” self, a political sense of self; people can achieve more power in their household or community as a result of loan services. On the other hand, MFIs have impacts on borrowers’ “internal” self, a teleological sense of self; people feel attached to a higher level institution which they are able to freely and voluntarily join or leave (Ledgerwood 2013, 48).

New Public Sphere. Traditionally, a public space is unavoidably associated with state or governmental organizations. But the “public” spaces of “mass private property,” (Shearing and Stenning 1983, 496) which are created by NGOs in the conventionally non-public sector for quasi-public purposes and the common good, have led to a blurring of the public/private distinction.

Regular meetings and workshops in the microfinance system create a similar quasi-public space, a sphere forged by NPOs for members’ public life. In this “public” sphere, microloan borrowers not only discuss group affairs but also start to contribute to each other’s family activities, patronize each other’s microenterprise, and exchange business information and in-kind favors (Chua et al. 2000, 91). This “public” life helps members of the borrower group share their information, knowledge, experience, and emotions (Dowla 2006, 117). They therefore enhance their networking skills and enlarge their social capital, which gradually enables them to invest in the communal life (Larance 1998, 30). Gradually, they not only supervise others’ status of repayment, but also start to pay for each other’s missing repayments in order to increase the whole group’s collective benefit (Dowla and Barua 2006, 77). That is, the old group lending mode of microfinance, on

the basis of peer pressure and social sanction, is sublimed to a new mode of public cooperation.

In addition, the ritualization of MFIs' discipline codes also makes regular meetings and workshops in the microfinance system sanctified as a "public" sphere outside the family and the kinship, which used to be dominated only by the state or religious groups in the pre-modern context. This new "public" sphere not only broadens members' horizons but also helps them define their new personal identity in the associated life (Hashemi, Schuler, and Riley 1996, 636). Acting as a ritual of modernization, MFIs' discipline codes connect all members and strengthen their confidence and capacity of controlling their own time, assets, income, and future. Finally, they realize how to socially interact with other people outside their family. The life in the microfinance system constitutes a forum for members to learn leadership and social skills, deliberate public affairs, and mutually enhance their social and political consciousness (Auwal 1996, 36).

By hosting regular meetings and workshops, MFIs create an artificial and virtual "public sphere," in which borrowers participate in microfinance programs and obtain an apprenticeship of democracy through the self-managed solidarity groups (Ben Hamida 2000, 8). This "idealized" public space strengthens democratic virtues such as open-mindedness, tolerance, and respect for opposing viewpoints, while also creating an informed and reasoned public opinion (Marsh 2000, 258). Due to their enhanced self-confidence and expanded social experience, many microloan borrowers found it possible to take part in the political, the "real" public, sphere (Dowla 2006, 117). Their participation in the borrower group can be viewed as a kind of Participatory Budget, an open and democratic process of participation which enables ordinary members to deliberate and make decisions collectively about budget-allocations (See Schugurensky 2004). Like Par-

ticipatory Budget, MFIs invite borrowers to take part in regular meetings and audit financial statements or review MFIs operational standards. All of these participatory activities actually promote members' solidarity and concern for the common good.

Through participating in regular meetings, microloan borrowers learn how to discuss public issues and run democratic procedures, which ensures the transparency of financial transactions in the whole microfinance system (Dowla and Barua 2006, 79). They therefore become decision-makers, leaders, and a social force (Latifee 2000, 7). As a result, MFIs have become part of the social reformer; borrowers' social force has become MFIs' power to fight against economic, social, or political injustice.

## **2. Economic Theories of the Microfinance Argument:**

### **Modernization, Economic Development, and Economic Fairness**

In this chapter, two sets of economic theories of democracy supporting the microfinance argument are discussed; they are the democratic theories of modernization and economic development, and the democratic theories of economic fairness. These two sets of economic theories are not only theoretically plausible but also supported by various empirical findings, although they once faced different challenges of cacophonies. Through these two economic theories, microfinance is seen as a feasible strategy of democracy-promoting, due to its possible contributions to increase the economic development and fairness.

#### **Democratic Theories of Modernization and Economic Development**

The first theory supporting the microfinance argument defined in this thesis is the democratic theory of modernization and economic development, which could be categorized into three perspectives: The first claims that economic development facilitates democracy. The second sees the other way around. And the third interprets them as two mutually reinforced factors. There has been found a strong positive relationship between economic development and democracy: Higher levels of economic development significantly increase the probability of democracy (Diamond 1992, 466). Though some researchers argued that the relationship between economic development and democracy might not be linear and there might exist multiple intervened factors amid the causal relationship (See Acemoglu et al. 2008; Arat 1988; Bourguignon and Verdier 2000; Diamond 1992; Huber, Rueschemeyer, and Stephens 1993; Inglehart 1988; Jackman 1973; Muller and Seligson 1994; Muller 1995; Neubauer 1967; Olsen 1968; Smith 1969), these cri-

tiques have not actually challenged the core proposition of the modernization theory (Cheibub and Vreeland 2012, 9). It might be reasonable that there are many different dimensions of socio-economic development collectively having a multiple co-relation with the level of democratization (Olsen 1968, 708–9), but the weight of the evidence suggests that the “level of economic development appears to be the dominant explanatory variable” in determining political democracy; it can explain most of the variance by itself than do other variables collectively (Bollen and Jackman 1985, 449).

Capitalist economic development created the burgher class whose existence was both a catalyst and a necessary condition for democracy. The strength of the middle classes in the society resulted in an alignment between burghers and throne and thus facilitated the legitimation of democracy among the conservative strata. The existence of a strong and independent bourgeoisie is a necessary (though not sufficient) condition for economic development and democratization. Without the bourgeois class, economic development may lead to authoritarianism under authoritarianism or fascism (Boix and Stokes 2003, 524). In addition, the working class, economically expanded and politically strengthened by capitalist development, by nature has an unambiguous preference for modern democracy (Cheibub and Vreeland 2012, 30–31): Since capitalist development had transformed the class structure, the enlarged working and middle classes started to self-organize, which made it more difficult for elites and landlords to monopolize political power (Huber, Rueschemeyer, and Stephens 1993, 83–84). Due to the successful democratic exercises in Western Europe and North America, democracy has been directly linked to economic development and social well-being. As Olson (1993, 573) indicated, most of the richest and liberal countries in the world are democracies. It is well-believed that democracy is



deeply related to economic development (Lipset 1960, 31); economic development and the pro-capitalist regime are believed to induce non-democracies to democratize and facilitate the consolidation of democracy. A more economically well-to-do society has greater chance to turn itself into a democratic regime or sustains its existing democracy (Lipset 1959, 75).

Most democratic transitions around the world occurred at the middle level of economic development because democratization is unlikely to occur in poor countries while it has already occurred in rich countries. About two-thirds of democratic transitions occurred in countries with USD 300 and USD 1,300 per capita gross national product (hereafter GNP) (1960 U.S. dollars) (Huntington 1991, 62). Furthermore, economic development not only works to foster democracy, it also provides necessary grounds for democracies' political reform (Burkhart and Lewis-Beck 1994, 907). As observed by researchers, economic development powerfully maintained democracy during the period of 1950–90; a poorer country has greater likelihood of its breakdown of democracy (Diamond 2008, 6–7). Countries with high per capita GNP are less likely to change their forms of government (whether or not democratic), since successful countries tend to retain their political strategies (Hannan and Carroll 1981, 30–31).

Economic development (which is usually represented as industrialization, urbanization, high educational standards, and a steady increase in the overall wealth of the society) is one of the basic conditions sustaining democracy. That is, high levels of socio-economic development are associated with not only the presence but also the stability of democracy (Diamond 1992, 466). Industrialization creates the necessary economic foundation for both social mobilization of the population and ensuing political development

(Olsen 1968, 710). Economic development thus has a strong causal impact on democratic survival (Cheibub and Vreeland 2012, 9–10). On average, a society needs at least 20 years of democratic experience to fulfill the egalitarian effect, which is the key to restrain the urge of revolution (Muller 1988, 57). During the first generation of democratization, economic development provides the society necessary sustainability, while the democratic regime provides the legitimacy of governance. Together, effectiveness and legitimacy compose the social system maintaining a stable democracy (Lipset 1959, 86).

On the other hand, political democracy buffers the developing nations from the adverse effects of dependency conditions on social well-being and democratic disarticulation (Wickrama and Mulford 1996, 387). As Olson (1993, 567) indicated, democracy is the perfect securer of necessary conditions for economic growth, and democracy is the most possible political institution encouraging citizens as individual economic actors to be productive (i.e. the best environment promoting economic growth). The logic behind these shared analogies is quite clear: In order to boom economy, it is widely assumed that citizens' self-governance is necessary rather than preferable; the greater the government's control of the economy, the lower the level of democracy (Bollen 1979, 572). Since democracy has justifiably enjoyed the almost universal appeal of the spirit of rule of law, the transparency of government, and the idea of accountability, democracy brings citizens good governance and therefore a prosperous economic growth (Sharma 2007, 33–36).

All successful Western political practices suggest the excellency and superiority of democracy. In return, these successful experiences legitimize the universal applicability of democratic values. These values and the derived concepts of human rights, fundamental freedom, or independence (United Nations 2005, art. 135), are conversely perceived as

the major reason of the great economic growth (see United Nations 2007, para. 6). As a result, the free-market capitalism has been widely accepted as the sole route to the “normality” of economic development (Hobson 2009, 383). Capitalism, free-market institutions, and economic prosperity are eventually seen as the totem of socio-economic modernity and the equivalent of democracy (Lehning 1998a, 234).

Both democracy and economic development need a well-respected and unambiguous legal institution and the spirit of “rule of law” as their infrastructures. A well-developed society hardly disrespects the transactions of the market, since a well-functioned market could only be built on the mutual trust among traders. With the help of this trust, rational egoists are gradually turned into effective cooperators (Newton 1997, 576). The mechanism of coordination based on social norms not only has been an important part of modern technologically sophisticated economic activities (Fukuyama 2001, 10), but also plays an important role in citizens’ political engagement. Since the general public prefers a gradual reform of society rather than a revolutionary change or the intransigent defense for the *status quo*, economic development and the enlarged working and middle class by nature tend to call for liberal democracy (Muller and Seligson 1994, 635).

### **Democratic Theories of Economic Fairness**

The second theory supporting the microfinance argument defined in this thesis is the democratic theory of economic fairness. Likewise, there are three perspectives: The first claims that an unfair economic distribution would induce non-democracies to democratize. The second asserts that a democratic institution would reduce economic inequality or alleviate poverty among citizens. And the third sees the bi-directional causal relationships between economic fairness and democracy.

The rising economic inequality in a non-democracy, which usually results from industrialization, increases social unrest among citizens; resentments and frustrations would weaken citizens' allegiance to the regime (Dahl 1971, 103), which causes "legitimacy deflation" of governance (Nordlinger 1977, 93). In order to avoid the threat of revolution, political elites in non-democracies reluctantly choose to extend the franchise to and share their political power with the common people. That is why some researchers see economic fairness as the single strongest factor influencing the level of democratization (Muller and Seligson 1994, 636): the greater economic inequality exists, the less people trust in existing political institutions (Karl 2000, 156).

Proponents of this argument believe that there is a direct causal relationship between economic inequality and democratic instability, which mainly works through the structure of property ownership; the society will fall into the "vicious cycle of inequality" and severe cleavages among social groups, if the economic inequality keeps increasing (Barry 2012, 128). In that case, a democracy can hardly sustain itself as long as the high level of economic inequality prevails (Karl 2000, 156). That is, economic development *per se* cannot automatically guarantee the democratization or the consolidation of democracy.

Some researchers believe that democracy, as a popular regime, will eventually cause economic equality among citizens since modern democracy provides citizens the opportunity to participate in the political process and therefore facilitates egalitarian political decisions. Ruling parties in a democracy will propose various pro-welfare policies to satisfy voters' basic needs in order to win elections. That is, democracy provides political incentives in keeping the government responsible and accountable, and therefore reduces the probability of presence of despotic tyranny. Once the government hears the real voice

of people, it will understand how to improve people's economic, social, and political conditions (A. K. Sen 1999, 10–11).

A democratic process helps people's voices be heard by "themselves" as well. People among different social groups will have consensus only if they all have the opportunity to fully express themselves and sufficiently discuss debatable issues. Otherwise, the majority of the society will tend to make the political process subjected to their own interests rather than the minority's basic needs. Through the open dialogue and debates (between the government and the people, or between different social groups) in the democratic process, democracy helps most, if not all, citizens understand each other's needs, preferences, and priorities, which are necessary for constructing fair and consensual decisions (Sharma 2007, 38). It is thus reasonable to expect that a popular regime to become associated, in a facilitative sense, with a gradual reduction of economic inequality in the long run (Lenski 1966, 318–25).

In addition, some researchers see a causally bidirectional relationship between economic fairness and democracy. In democracies, the growing political power of the urban lower income groups led to various protective and supporting legislations. As a result, there is an inverted U-shape curve indicating the relationship between economic inequality and per capita income (See Kuznets 1955). Likewise, this Kuznets-like curvilinear relationship also exists between economic inequality and the level of democratization, as a study shows: economic fairness and democracy have a positive curve in poor countries, whereas having a negative curve in rich countries (Chong 2004, 208). This curvilinear argument is also supported by historical case studies of Western societies such as Britain, France, Germany, and Sweden (See Acemoglu and Robinson 2000) and explains why

countries at intermediate levels of economic development often have difficulty sustaining a stable democracy (Muller 1995, 981).

The Kuznets-like curve between economic fairness and democracy might be seen as the best indicator of political stability in democracies (Karl 2000, 155). Democracies with severe economic inequality are actually unstable, and it is difficult for them to function correctly or even to maintain themselves as a polity (Karl 2000, 156). In that case, the urge for reducing inequality will emerge a “new democratic ideology” (Lenski 1966, 17), which legitimizes the redistribution of political power in favor of the majority; economic inequality would induce the society to turn itself into the process of democratization in the first place, and the democratic regime then makes itself reinforced by keep reducing economic inequality in return. In this sense, the best indicator of democratic stability is the degree of economic equality, rather than the level of economic development. As an observation shows, most stable and lasting democracies were equitably prosperous; on the contrary, most democratic regimes with highly economic inequality suffered their institutional breakdowns (Muller 1988, 64–65 figure 1).

### **Microfinance, Economic Development, and Economic Fairness**

Proponents of the microfinance argument believe that microfinance will encourage democratization or facilitate consolidation of democracy by promoting economic development and reducing economic inequality. By providing necessary start-up capital, microfinance helps poor borrowers have an income-bringing or self-sustainable career. Due to its “self-help” strategy, microfinance becomes a feasible solution for poverty alleviation. In addition, microfinance could be beneficial to the overall society by overcoming the poor’s liquidity and unemployment problems through setting up small businesses,

funding the construction of homes, creating savings accounts, and funding further education for children (Shahidur R. Khandker 1998, 5–6). It is accordingly believed by researchers that microfinance is able to increase economic development, reduce economic inequality, and eventually empower the poor (Barry 2012, 133). Likewise, it is believed by the United Nations as well that microfinance could facilitate its Millennium Development Goal of eradicating extreme poverty and hunger (See United Nations 2013).

The logic behind this argument is that a country can reduce its economic inequality by alleviating poverty. In most developing countries, the problem of high economic inequality is usually related to their imperfect financial markets: Due to immature financial regulations and poor administration of justice, “well-connected” political elites plundered resources by rent-seeking activities and crony-capitalist corruption; conversely, normal people can hardly obtain capital to invest in their businesses or in themselves. While moral hazard and adverse selection are rampant in a country’s financial market, its economic inequality will unstopably increase (Kai and Hamori 2009a, 238).

It is thus well-believed that lack of financial capital substantially impedes the growth of small businesses (Green, Kirkpatrick, and Murinde 2006, 1026). As an observation of small businesses in Russia and Eastern Europe before 1992 shows, the poor could hardly find their way out since their small businesses were announced illegal then by the communist government and they could not obtain enough alternative resources to reproduce or improve their living conditions (Mosley, Olejarova, and Alexeeva 2004, 410). Considering most MFIs in developing countries are more or less sponsored by government funding or international charity, microfinance could act as a “game changer” of the financial market by breaking through the financial blockage and by providing the poor precious fi-

nancial capital. For that reason, it is well-believed that microfinance can help the poor increase their income by enhancing their productivity. Due to the small amount of installment, microfinance encourages borrowers to allocate credit efficiently and therefore to increase the poor's reproductive assets (Jalilian and Kirkpatrick 2002, 98), especially for the landless or the proletariat (Hossain 1988, chap. 3). For example, as a study of the Center for Agriculture and Rural Development (now CARD Bank) in the Philippines shows, one unit of microloan can generate a gross income of three-point-zero-three times in return (Hossain and Diaz 1997, 111–12). In addition, microfinance can help the poor accumulate capital. Due to the nature of smaller amounts and shorter recovery periods, it is easy for borrowers to repay the installment from their income flow and keep the reproductive capital intact (Hossain and Diaz 1997, 108). As an observation shows, the amount of working capital employed by borrowers increased three times during 27 months (Hossain 1988, 10). Microfinance can also enhance the poor's consumptive capacity. As another observation shows, borrowers' per capita expenditure in the household rose about 20 percent since participating in the system (M. Pitt 1999, 6–7). Likewise, microfinance can help the poor improve their quality of life. Through improvements in housing, water, and sanitation, microfinance helps poor families reduce their ratio of expenditures on basic living needs and enhances their human capacity (Bayulgen 2008, 531). In addition, microfinance can help the poor manage their risk of life and decrease the consumption volatility in their household (See Parker and Nagarajan 2000). Due to their long-term access to microloans, microfinance members have become less vulnerable (Dowla and Barua 2006, 44): With the help of self-training of productivity, borrowers gradually increase their capacity to cope with external shocks (such as natural disasters) at the indi-



vidual level. As a study shows, a one year increase in microfinance membership reduces the percentage change in per capita consumption caused by a unit shock by six percent (Nidhiya 2003, 20–21). On the other hand, the mechanism of mutual-help in the microfinance system helps members decrease the household's consumption volatility (Kai and Hamori 2009a, 239) and eventually achieve consumption-smoothing on the collective level. As a study shows, a borrower having seven-point-five-eight years of membership encountered only zero-point-eight-five percent of change of consumption between seasons, whereas an average borrower having four-point-one-five years of membership suffered 11.48 percent of change of consumption; while a brand-new borrower needs six-point-five-one percent of annual income as the certainty equivalent to stay in the microfinance system, an average borrower having four-point-one-five years of membership only needs three-point-two-one percent of average annual income (Nidhiya 2003, 20–21). All of these findings suggest that microfinance can not only enhance the poor's sustainability but also decrease the whole economic inequality in the society (Kai and Hamori 2009b, 3).

Clearly, microfinance did help the poorest out of their worst situation. According to empirical findings, there were only 61 percent of borrowers below the poverty line, compared with the figure of 80–84 percent of the general population in Bangladesh. Meanwhile, the population of moderate poverty among borrowers was reduced by eight-point-five percent over seven years, while the extreme poverty dropped by 18.2 points (S. Khandker 2003, 17).

In addition, there were 57 percent of borrowers who crossed the poverty line in a 10-year period, while the general population was 18 percent; 42.5 percent of borrowers who

were still poor, while the general population was 82 percent; 48 percent of borrowers lived in extreme poverty, while the general population was 75 percent (Hossain 1988, 68). Among the poor, there are only 72.5 percent of borrowers were extremely poor (Todd 1996, 236). There were about 21 percent of Grameen members who moved out of poverty within a span of four-point-two years of membership (Shahidur R. Khandker 1998, 56). In general, microfinance reduces the probability of being below the poverty line by zero-point-three percent for males and zero-point-two percent for females (Shahidur R. Khandker 1998, 58–59). Likewise, all of these findings suggest that microfinance can effectively reduce poverty (Ahlin and Jiang 2005, 27).

It is well-believed that microfinance has the potential to act as an effective tool to equalize the outcome of economic development by easing capital constraints on the poor and by decreasing economic inequality (Kai and Hamori 2009b, 10). By increasing the poor's income and lowering the rich's gain, microfinance could be used as an effective redistribution tool (Kai and Hamori 2009a, 245). As the former Secretary-General of the United Nations Annan said, “[m]icrofinance has proved its value, in many countries, as a weapon against poverty and hunger[; i]t really can change peoples' lives for the better — especially the lives of those who need it most” (See United Nations n.d.).

Moreover, microfinance can facilitate social inclusion by helping those once-excluded rejoin the mainstream of society. Poor people, especially rural females, had been deliberately marginalized by traditional financial institutions for a long time, due to lack of valuable collateral, trustworthy credit history, and stable income flow (Chatnani 2010, 27). With microfinance's help, the poor have gradually been re-included into the society. In that case, microfinance has been the perfect alternative of government-subsidized

handouts after the paradigm shift of the idea of welfare policy since the 1970s (Barry 2012, 130).

Proponents of the microfinance argument believe that microfinance will facilitate democracy by increasing economic development, alleviating poverty, and reducing economic inequality. In this sense, microfinance embodies the democratic ideal of equal redistribution through promoting the “capitalist market-oriented” economic development. On one hand, microfinance helps the Leftist, who usually have the least access to governmental resources or public goods, be re-included. On the other hand, microfinance assists in the creation of an independent Rightist class of “small capitalists” thriving without state’s direct support, especially in post-communist areas (Mosley, Olejarova, and Alexeeva 2004, 410). Together, microfinance fulfills a gradual change and a steady reform through increasing the poor’s economic, social, and political capacity and engagement, which echoes the Western liberal democratic institutions. In other words, microfinance indirectly enhances democracy through its success in increasing economic development, reducing inequality, and empowering the poor (Barry 2012, 129).

### **3. Social Theories of the Microfinance Argument: Gender Justice, Social Capital, and Civil Society**

In this chapter, three sets of social theories of democracy supporting the microfinance argument are discussed; they are the democratic theories of gender justice, the democratic theories of social capital, and the democratic theories of civil society. Like the economic theories of the microfinance argument, these three sets of social theories are also theoretically and empirically supported respectively. Therefore, through these three social theories, microfinance is seen as a reasonable choice to cultivate the democratic ground of the participatory citizenship and deliberative democracy.

#### **Democratic Theories of Gender Justice**

The third theory supporting the microfinance argument defined in this thesis is the democratic theory of gender justice. It is well-believed that reducing gender inequality will induce non-democracies to democratize and consolidate existing democracy. This belief could be deduced through two different perspectives: economic and political. Proponents of the economic perspective believe that economic development can improve gender equality by breaking down traditional gender divisions of labor within the household and the economy, providing incentives for more equal investments in human capital and reducing discrimination in the labor market (Mason and King 2001, 228). Because industrialization brings higher occupational specialization, rises in educational levels, and increases in levels of income, it is argued that economic development, or the process of modernization, will simultaneously lead towards both gender equality and democratization, (Inglehart, Norris, and Welzel 2004, 5). Some researchers see gender equality as the necessary process of the modernization and the transformation of industrialized societies,

rather than the consequence of democratization induced by economic development (Inglehart, Norris, and Welzel 2002, 321). For that reason, although political conservatism of some cultural traditions might retard the process of modernization, the underlying trend toward both gender equality and democratization eventually becomes irresistible in the long run (Inglehart, Norris, and Welzel 2004, 5). Conversely, some researchers believe that gender inequality has a negative impact on economic development. This negative impact, the cost of gender inequality, could be particularly significant in today's globalized world. Inequalities in resource distribution and opportunity have a negative influence not only on oppressed women but also on the whole society, and therefore would impede its development (Mason and King 2001, 73–74). For that reason, improving gender equality should be considered as part of any sustainable strategy (or even the premise) for development. Empowerment of women and gender equality should be seen as prerequisites for achieving political, social, economic, cultural and environmental security among all peoples (United Nations 1995, para. 41).

On the other hand, proponents of the political perspective see the factor of gender equality itself more crucial than the factor of economic development, although they might still acknowledge the latter's impact. Gender equality matters on the level of democratization much more than economic development since the power of ideas or cultural norms is more pivotal than institutions or laws (Inglehart, Norris, and Welzel 2004, 7). Countries in which the public is commonly in favor of the idea that “men make better political leaders” have relatively lower proportions of female members of parliament, which suggests that the factor of cultural norms has much greater impact than the democratic constitution (Inglehart, Norris, and Welzel 2002, 325). In addition, some researchers even see eco-

conomic development as an important factor only if it helps change prevailing gender norms (Inglehart, Norris, and Welzel 2004, 8). As Rizzo, Abdel-Latif, and Meyer (2007, 1165) shows, people in non-Arab Muslim societies are more likely to support women's rights, and as well as democracy; on the contrary, the reverse is true in Arab Muslim societies. Some researchers accordingly use the level of support for gender equality as an indicator of tolerance and personal freedom, and therefore the level of democratization (Rizzo, Abdel-Latif, and Meyer 2007, 1152). Theoretically, being equal, at least constitutionally, is the core value of democracy; democracy is established in and by "legal rules" which are valid in that (a) they have been sanctioned following due procedures, and (b) the rights and obligations in law are universally applicable; every citizen, no matter the sex, is considered a legal person (O'Donnell 2004, 33), i.e. "all [persons] are equal before the law and that the law is no respecter of persons" (Carrington 1922, 481). Another study shows that a democratic society usually has more female politicians and governmental officials than its counterpart, and the relationship between support for gender equality in politics and the society's level of political rights and civil liberties is remarkably strong (Inglehart, Norris, and Welzel 2002, 323, 330). For that reason, researchers see it reasonable to inquire the extent of democratization by measuring women's empowerment since the quality of democracy is determined not only by the form of institutions but also by how fairly diverse social groups are treated (Moghadam 2004, 2–3). After all, a democracy is not necessarily a gender-equal society, but the converse is true.

Gender equality can improve the chances that a democratic institution can emerge and flourish. Support for gender equality is not just a consequence of democratization; it is the embodiment of democratization, intellectually and constitutionally; it is part of a

broad cultural change, transforming industrialized societies and supporting the spread of democratic institutions (Inglehart, Norris, and Welzel 2004, 3). A democratic system without gender equality is a degenerate form of democracy. Women need democracy to flourish, but the converse also remains true: a true democracy needs female citizens' participation to fulfill itself in order to accomplish an inclusive, representative, and enduring system of government (Moghadam 2004, 3).

### **Microfinance and Gender Justice**

Proponents of the microfinance argument believe that microfinance will promote democratization or facilitate consolidation of democracy by diminishing or reducing gender inequality. It has been found that microfinance has positive impacts on women's income, employment, consumption, fertility, and decision-making power. For example, the United Nations sees the access to "bank loans, mortgages and other forms of financial credit" as a fundamental human right and a powerful tool to eliminate discrimination against women in economic and social life (United Nations 1981, art. 13); it also requires all its member states to provide enough financial resources to fulfill their commitment to equal rights, responsibilities, opportunities, and participation of policy-making processes on the basis of gender equality (United Nations 1995, para. 36).

It is well-established that microfinance can help poor women escape from poverty and economic inequality by increasing the female labor supply. Microfinance has enhanced female borrowers' productive means by increasing their access to cash income generation from market-oriented small businesses as well as by increasing their ownership of non-land assets (Shahidur R. Khandker 1998, 48–49, 149–50). As one observation shows, the non-land assets of female borrowers increased by 15–29 percent of the total

amount borrowed; after joining the microfinance system, female borrowers earned a regular cash income and increased their family income by around 72 percent; the female labor supply in areas served by MFIs significantly significantly increased as well (Hassan 2002, 233–34). As a result, microfinance helps rural poor women fix the predicament of lack of knowledge and skills to find full-time jobs in the mainstream economy (N. K. Shetty 2008, 95). Likewise, it was found in a study of MFIs in Calcutta that borrowers have a significantly higher income compared with non-borrowers (M. M. Banerjee 1998, 78); and this impact is gender-differentiated since it influenced on male microfinance members' employment only marginally and insignificantly, as a study of Grameen replications in the Philippines shows (Hossain and Diaz 1997, 109–10). Though some researchers might criticize it as just a palliative response to the economic distress of poor women, microfinance's usefulness for the poor's capital accumulation is still recognized (Keating, Rasmussen, and Rishi 2010, 162–63).

In addition, the increase in assets and cash income attributed to microfinance enhances female borrowers' status in their households. With microfinance's help, female borrowers in abusive relationships were able to gradually decrease their dependence on husbands, as a case study in Bangladesh shows (Kabeer 1998, 43–54). Microfinance helps women form a resistance to their husbands' wife beatings and alcoholism (Shrestha 1999, 30). By utilizing their social capital generated in the microfinance system, female borrowers exchange information which reveals their abusive situation (Sanyal 2009, 538–39), initiate collective actions to sanction male abusers, or call for help from the authorities (Rouf 2012, 289–90). As an observation of WWF members shows, 40.9 percent of microfinance members who had experienced domestic violence were able to stop it;



while 10.2 percent stopped it due to their personal empowerment, 28.7 percent stopped the domestic violence through group action (Working Women's Forum 2000, 22). Microfinance also helps reduce domestic violence against women by channeling resources to families through female borrowers (Schuler et al. 1996, 1740), reduce quarrels about financial problems in the household, and increase respect from their husbands (Cheston and Kuhn 2002, 21). Clearly, the relationship between participation in microfinance and the reduction in abuse is direct and hardly suspicious (Kabeer 1998, 44); bringing financial resources to their household alone was enough for female microfinance borrowers to improve their spousal relationships (Kabeer 1998, 21).

It might be common for women in developing countries to under-perceive their own contribution in the household, which depreciates their status in the household (A. Sen 1987, 24). However, it is well-established that microfinance helps female borrowers re-adjust their perceived contribution and breakdown position. With microfinance's help, female borrowers' position of negotiation in the household is significantly enhanced. Most female borrowers not only experienced an increase in knowledge of resource management, decision-making, and self-esteem, but also had considerable power in utilizing and managing their microloans. For example, as an observation of Grameen members shows, 97 percent of borrowers felt that the wife contributes more to the family, compared with 77 percent of non-borrowers (Dowla and Barua 2006, 48–49). Approximately, 82 percent of Grameen members reported being empowered to control their microloans, rather than their husbands (Rouf 2011b, 17, 23).

Researchers had similar findings in an observation of Nepalese MFIs: most female borrowers made business decisions jointly with their husbands, compared with the past

when their husbands dominated the whole decision-making power before their participating in the microfinance system (PLAN International n.d., 37). Around 68 percent of female borrowers in the Women's Empowerment Program in Nepal experienced an increase in their decision-making roles in family affairs (Ashe and Parrott 2001, 8). Likewise, the percentage of female borrowers in the Philippines who make financial decisions in the household increased from 33 to 51 percent after joining the program, while only 31 percent of general female adults increased their household decision-making power, and the percentage of female borrowers managing their enterprise funds increased from 44 to 87 percent (See Ledesma 2002, as cited in Cheston and Kuhn 2002). In Rwanda, as an observation of MFIs shows, 54 percent of borrowers experienced an increase in their ability to control or influence business decisions, and 38 percent, mostly female, experienced an increase in decision-making in their families (World Relief Rwanda 1999, 4, as cited in Cheston and Kuhn 2002).

There is a significant trend that female borrowers are reducing their dependency on their male family members and have a more equitable relationship in the household (Dowla and Barua 2006, 46). Since most MFIs intentionally adopt democratic and consensual decision-making processes to operate the borrower group, this experience and training induces female borrowers to adopt a similar philosophy to manage their households (Rouf 2011c, 60), which leads women to take a greater role in the decision-making processes, have greater bargaining power *vis-a-vis* their husbands, and have greater freedom of mobility (M. M. Pitt, Khandker, and Cartwright 2003, 30).

The civic and democratic education provided by MFIs help remove barriers in empowering women against male domination in household and community; more and more

poor women now feel confident to go outside and participate in social life (Hassan 2002, 233). As an observation shows, about 96 percent of Grameen members communicated with their neighbors more than once per month while 56 percent of them did not know their neighbors before (Rouf 2011b, 23). Researchers had similar findings in an observation of MFIs in Rwanda: 69 percent of borrowers reported having an increase in self-esteem (World Relief Rwanda 1999, 7, as cited in Cheston and Kuhn 2002). With microfinance's help, many rural women now are able to participate in their communal life. For example, female borrowers of the Centre for Self-help Development (CSD), a Nepalese MFI, collectively own houses available to CSD, which uses them as a social space for communal gathering (Shrestha 1999, 18). Likewise, microfinance participants participated in communal affairs significantly more than non-participants, as a survey of MFIs in Ghana conducted by Freedom From Hunger shows: At the time of survey, 87 percent of borrowers had given business advice in the last six months, compared with 44 percent of the same respondents before joining the microfinance program three years earlier, as well as 35 percent of non-participants and 50 percent of members of control communities (MkNelly and McCord 2001, 9–10). Once poor women join the microfinance system, they will not only “see” what the real meaningful community is but also “be seen” with respect in both their homes and the community (Hashemi 1997, 115).

As a result, microfinance facilitates not only social but also legal and political empowerment of women. The cultural and social changes induced by microfinance carry out various pro-gender-equality laws and institutions. While some NPOs actively have used microfinance as an opportunity to mobilize women on gender issues (Bayulgen 2008,

528), most MFIs unintentionally and indirectly but actually promoted female borrowers' political and legal empowerment.

For example, GB uses women-exclusive housing loans to protect female borrowers' ownership of their houses so that they will not be evicted from their own house due to divorce (Dowla and Barua 2006, 50). Likewise, Human Development Initiatives Nigeria (HDI), a Nigerian MFI, helps widows legally reclaim their husbands' inheritance and gain legal access to their joint bank accounts (Cheston and Kuhn 2002, 25). Microfinance helps women become cooperative and autonomous by mobilizing the collectivities (Keating, Rasmussen, and Rishi 2010, 163). By enhancing poor women's knowledge and self-confidence and by enlarging their social capital, microfinance also provides them necessary tools and skills needed for formal democratic processes (Cheston and Kuhn 2002, 25), which eventually facilitates their sense of political efficacy (Rouf 2011a, 124). All in all, microfinance encourages women's civic engagement and therefore exemplifies a political renegotiation, turning the biased and exclusive social contract into a more equitable, inclusive, and democratic one (Keating, Rasmussen, and Rishi 2010, 163; Keating 2004, 423–27), which leads more women to participate in existing democratic regimes (See Barry 2012; Bayulgen 2008; Cheston and Kuhn 2002; Hadenius and Uggla 1996; Hashemi, Schuler, and Riley 1996; Rouf 2011a; Yunus 2002).

### **Democratic Theories of Social Capital**

The fourth theory supporting the microfinance argument defined in this thesis is the democratic theory of social capital. It is well-believed that enlarging or accumulating social capital can induce non-democracies to democratize and facilitate the consolidation of democracy (See Putnam 2001). Social capital, according to World Bank's definition, is

“the norms and social relations embedded in the social structures of societies that enable people to coordinate action to achieve desired goals” (World Bank 1999, 1). Social capital is “the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition” (Bourdieu 1997, 51). It refers to social organizations, such as trust, norms, and networks, which are able to improve the efficiency of society by facilitating coordinated actions (Putnam, Leonardi, and Nanetti 1993, 167). It is also a subjective phenomenon composed of a range of values and attitudes of citizens that influences or determines how they relate to each other, which predisposes citizens to cooperate, trust, understand, and empathize with each other — to treat each other as fellow citizens, rather than as strangers, competitors, or potential enemies (Newton 1997, 575–76).

Since social capital consists of not only aspects of social structures but also certain actions of actors within the structures (Coleman 1988, 98), it consists of three elements: (a) norms and values, (b) networks, and (c) consequences; together, social capital produces collective facilities and resources (Newton 1997, 575). In any case, social capital is necessarily economically productive, although it mainly enhances the efficiency of the combination process of various resources and types of capital. As Putnam (1993, 36) indicated, social capital “enhances the benefits of investment in physical capital and human capital.” In other words, social capital is not only an input into the system of production but also a shift factor of the entire production function (Grootaert 1998, 9).

Trust among economic actors and in the institution works as the platform that makes transactions of the market possible. It is trust that turns rational fools into effective cooperators (Arrow 1972, 357). Therefore, a strong co-relationship exists between social

capital and economic growth. As Simmel (1950, 326) indicated, social capital is “one of the most important synthetic forces within society.” It not only directly lowers transaction costs and reduces principal-agent problems, but also indirectly facilitates economic growth via investment in physical and human capital. Due to the diffusion of innovation facilitated by cooperative and trusting behaviors among citizens, a high trust society will be more effective (Whiteley 2000, 443, 452).

Social capital exists in the relationships between citizens and therefore is a communal network consisting of the social relationships (Coleman 1988, 113). The dense networks of civic engagement fostered by various civil associations are horizontal, as opposed to the vertical networks of patron-client arrangements or of traditional hierarchical organizations. With the help of social capital, citizens are able to trust others because of this embedded horizontal network of reciprocity (Bayulgen 2008, 533). Social capital helps citizens become capable of cooperating for mutual benefit and eventually of bolstering the performance of the polity and the economy, i.e. “[s]trong society, strong economy; strong society, strong state” (Putnam, Leonardi, and Nanetti 1993, 173, 176).

The horizontal network of trust and reciprocity are crucial for social and political stability and cooperation. It constitutes a force that helps bind society together by transforming individuals from self-seeking and egocentric calculators into fellow citizens with shared interests, shared social relations, and a shared sense of the common good (Newton 1997, 576). These shared identities can better motivate and facilitate citizens’ collective actions. The norms and routines produced within and across these networks can create a sense of citizenship and produce a habit of political participation. With the help of social capital, people are able to create their own radius of trust. Social capital is, therefore, re-

sponsible for converting the Hobbesian state of nature to a livable community, where citizens are able to cooperate with others through overlapping social groups (Fukuyama 2001, 8). Once a group's social capital produces positive externalities, the radius of trust will be larger than the group itself, and *vice versa* (Harrison 1985, 7–8).

Social capital is the glue holding various social institutions together (See World Bank n.d.). Coordination based on social capital plays an important part of modern sophisticated public affairs. It facilitates coordination and cooperation for members' mutual benefit as well as for the society as a whole (Foley and Edwards 1996, 46–47). In small face-to-face communities, “thick” social capital (Williams 1988, 8) is the essential ingredient of mechanical solidarity. Communities of this kind are generally socially homogeneous, isolated, and exclusive, and are able to exercise the strict social sanctions necessary to reinforce thick trust (Coleman 1988, 105–8). However, the “thick” social capital of primary relations is only capable of bolstering primary democracies that have emerged in the early stage of modernization (Newton 1997, 578). For that reason, the “thin” or abstract form of social trust is more than crucial for the governance and public affairs of a modern society (Misztal 1996, 72). On one hand, the political participation through parties or interest groups relies on the mechanism of in-group trust. On the other hand, the direct political participation of citizens relies on their trust of institutions, such as the electoral process. Together, social trust among citizens and between the ruled and the political institutions make democracy possible. Higher levels of social capital and a robust civil society may reduce the government's ability to directly oppress citizens and provide space for the growth of organized opposition to a non-democratic regime (Bayulgen 2008, 537).

## **Democratic Theories of Civil Society**

The fifth theory supporting the microfinance argument defined in this thesis is the democratic theory of civil society. It is believed that a strong civil society would induce non-democracies to democratize and facilitate the consolidation of democracy. A modern civil society is created through forms of self-constitution and self-mobilization. It is a realm of voluntary social interaction between market and state, which is self-generating, self-supporting, and autonomous (Diamond 1994, 5). It is a “set of diverse non-governmental institutions which is strong enough to counterbalance the state and ... can nevertheless prevent it from dominating and atomizing the rest of society” (Gellner 1994, 5). In this sense, civil society is a public sphere where citizens deliberate about their common affairs (Fraser 1990, 57) and is based on a tolerant recognition of difference and diversity (Hall 1998, 34), due to its nature presuming a diverse but specialized and professionalized citizenry (Munkler 2006, 98) who keeps interacting and communicating with each other (Bryant 1993, 399).

Civil society is such a social realm related to networks, norms, and trust, facilitating coordination and cooperation for social members’ mutual benefit (Putnam 1993, 35). In this realm, citizens can freely fulfill themselves by cooperating with each other voluntarily. With the help of social capital, collective actions are successfully transformed into iterated Prisoner’s Dilemma games, which means a win-win outcome is possible (Fukuyama 2001, 16–17).

In a liberal democracy, civil society serves to balance the government’s power and protect citizens. In the absence of a robust civil society, the government has no choice but to step in to organize atomized individuals who are incapable of organizing themselves



(Fukuyama 2001, 11). Instead, in an environment with a well-developed civil society, citizens are able to create and accumulate their social capital by participating in various voluntary associations. In this dense network of civic engagement, norms of generalized reciprocity and social trust could be conveniently fostered (Lehning 1998b, 35). Civil society with a denser network is highly likely to invite citizens to mutually cooperate for the common good (Putnam, Leonardi, and Nanetti 1993, 173, 176).

Voluntary associations play a critical role in civil society. They provide citizens an infrastructure to organize themselves and initiate collective actions, which produces a symbolic affiliation, an in-group identity, and social integration; they also forge a public forum for citizens to discuss public issues and shape their common knowledge (Minkoff 1997, 606–7). True meaningful citizenship can only be cultivated and fulfilled through civic engagement, i.e. participation in various voluntary associations or in communal activities from philanthropic deeds to socio-political movements, rather than any form of electoral participation (Benn 2000, 1). A healthy democratic regime needs intermediate civic associations to generalize common trust among citizens. From the bottom up, rather than the other way around, democratic institutions must be built up in citizens' everyday life of trust and civic engagement (Lehning 1998a, 239). For that reason, civil society is one of the prerequisites for a democracy, or even for any efficient functioning political system, because it cultivates citizens with the capacity of voluntary cooperation for common purposes (Hadenius and Ugglå 1998, 45).

Democratic participation needs a collective identity among citizens which incorporates the idea of people as collective agents of their own destiny. In addition, it also needs to adopt an everyday practice which encourages citizens to be active and collaborative

(Gamson 1991, 49). Therefore, social capital plays a political role in a modern democracy, i.e. to maintain the civil society and transform isolated individuals into sociable citizens. With the help of social capital, social individuals transform themselves into citizens in the political community, who are confident to interact with other citizens. In that case, social capital, public-spiritedness, and a robust civil society have become necessary elements of democracy (Lehning 1998b, 35). Likewise, citizenship needs to be learnt and it can only be cultivated in civil society through citizens' various types of voluntary participation (Benn 2000, 1). That is, civil society in fact plays the role of the "school of citizenship and democracy," where citizens learn the public morality of voluntary cooperation (See de Tocqueville 1898). Public morality and knowledge of civic associations, together, support democratic societies.

Once citizens are well-equipped and trained in civil society, they will know how to self-organize and self-mobilize against all potential tyranny. In this sense, civil society therefore is an autonomous sphere of social power where citizens can resist authoritarians, protect themselves from tyranny, correct unjust institutions, and democratize from below (Foley and Edwards 1996, 45–46). As cases of the democratization in Russia and Eastern Europe and in Latin America show, civil society energizes resistance to the tyrannical regime and provides an independent sphere of action for nurturing a pro-democratic regime (Foley and Edwards 1996, 38).

### **Microfinance, Social Capital, and Civil Society**

Proponents of the microfinance argument believe that microfinance will promote democratization or facilitate consolidation of democracy by helping the poor enlarge social capital, strengthening the civil society, and eventually converting social individuals into

autonomous citizens in a democratic society. Though poor people in most developing countries are short of physical capital, human capital, financial capital, and cultural capital, they usually have abundant social capital due to the nature of their rural life style and community-based economic activities (Balkin 1993, 253). However, poor people in developing countries can hardly utilize their social capital in the first place without the help of an MFI, due to lack of organizational skills, a short radius of trust, and poor knowledge of risk-management; normal villagers can hardly engage in collective action spontaneously. In that case, MFIs play the external agent to instill necessary skills and provide an enforcement mechanism (Woolcock 1998b, 132). Microfinance can help the poor not only organize themselves to initiate collective actions for their mutual interests but also enlarge, accumulate, and reproduce social capital.

Due to the spillover effect, poor people are able to utilize their social capital to develop other forms of capital. In the beginning, borrowers use their existing social capital developed in their personal networks as social collateral. After that, they gradually develop new social capital in the network of the microfinance system. Finally, they earn their credit history in the formal financial system by proving their trustworthiness. This spillover effect of social capital helps the poor voluntarily cooperate not only financially but also socially. For example, borrowers can not only share marketing information during regular meetings, but also use the networks to exchange scarce resources, swap household labor, and meet social obligations in the village (Larance 1998, 21). On one hand, borrowers use their social capital to monitor each other's repayment. On the other hand, they use their increasing economic capital and growing prosperity to oil these social networks (Todd 1996, 76). They even leverage their social capital fostered in the mi-

crofinance system to expand the networks horizontally to outsiders of the kinship group (Dowla 2006, 119). This spillover effect of social capital also works for MFIs. Borrowers not only develop and utilize their own social capital but also help develop a collective social capital for the whole industry of microfinance. For example, due to the high repayment rate since its inception, GB created a reputation of trustworthiness for the poor, indicating those once-excluded actually have financial potential. This positive reputation acts as a public good for all MFIs around the world. Almost every Grameen replication (whether or not official) enjoys the free-ride on this trust-building without necessary long-term investment (Amin, Becker, and Bayes 1998, 108–9).

More importantly, this spillover effect of social capital in the microfinance system can nurture an independent civil society (Hadenius and Ugglå 1998, 44–45). Microloans not only provide borrowers pecuniary returns but also enhance their social basis of self-esteem, mutual trust, and self-empowerment; as a result, borrowers have become citizens of solidarity (Berenbach and Guzman 1992, 15). With microfinance's help, borrowers are able to trust others in the community because of the horizontal networks of generalized reciprocity based on rational cooperation and social capital. For borrowers, the borrower group not only monitors their performance of repayment and motivates their incentive of being trustworthy, but also facilitates their collective actions. As a result, norms and disciplines introduced by MFIs help borrowers create a sense of interdependence with each other, a habit of participation, and a public morality toward the whole political community (Bayulgen 2008, 534, 537). The participatory democratic system adopted by most MFIs helps borrowers self-organize at the micro level of grassroots, develop their social capital, and then transform them into modern citizens (Rouf 2011a, 130–31). The democ-

racy in the microfinance system helps borrowers develop decision-making power in not only family but also public affairs (Amin, Becker, and Bayes 1998, 225). Though MFIs mainly focus on turning borrowers into creditworthy borrowers rather than active citizens (Rouf 2011a, 132), the process of participatory democracy that is run in the microfinance system actually enlightens citizens and encourages their engagement (See Schugurensky 2004). Microfinance therefore has the potential to go far beyond credit delivery; it can change borrowers' quality of life. In addition, it can create and cultivate social capital in the political community (Bayulgen 2008, 538). Though having limited impacts on formal association, microfinance has substantial impacts on patterns of informal association. Microfinance helps borrowers expand their informal social networks into the linkage with formal political institutions (Mosley, Olejarova, and Alexeeva 2004, 419). Marginalized people are thus empowered to resolve conflicts collectively in their neighborhoods (Rouf 2011c, 139). Furthermore, the participatory and deliberative democracy in the microfinance system improves borrowers' sense of political efficacy (Rouf 2011a, 126). As a result, the mutual trust built between the MFI and borrowers has another level of spillover effect on all other institutions in the society, which leads to multilateral and vertical trust-building in poor rural areas or urban slums (Dowla 2006, 110). By enhancing social capital, which in turn influences political development, microfinance influences formal political development (Barry 2012, 125); it constitutes an apprenticeship of democracy through the self-managed solidarity groups, and borrowers obtain the power that influences beyond their family (Ben Hamida 2000, 8). In other words, microfinance not only empowers borrowers financially and socially but also politically, especially in a pro-democratic direction.

#### **4. Critiques and the General Discussion of the Microfinance Argument**

In this chapter, various critiques of all aforementioned theories supporting the microfinance argument are introduced. Respectively, these critiques either oppugn the validity of the microfinance argument or doubt the desirable consequences of microfinance practices. However, as the general discussion made in this chapter shows, these critiques have not necessarily challenged the microfinance argument. On the contrary, these non-systematic, sporadic, and detailed critiques conversely exhibit that the microfinance argument is theoretically intuitive based on the common understanding of the experiences of modern democratic developments.

##### **Critiques: Economic Dependence and Unsustainability**

Some critics challenge the democratic theory of modernization and economic development. They argue that democracies are not necessarily a more economically efficient form of government than any other; democracies' rates of aggregate growth, savings, and investment are no theoretically better than non-democracies (Schmitter and Karl 1991, 85). For example, Muller (1988, 64) found a strong inverse association between democracy and economic development, and the level of economic development is seemingly the irrelevant variable. Likewise, although some researchers of African democracies indeed found positive examples in Botswana and Niger (Narayan, Narayan, and Smyth 2007, 909–10), others also found a counterexample in Chad (Narayan, Narayan, and Smyth 2011, 26). All of these findings of inconsistency are challenging the democratic theory of modernization and economic development.

On the other hand, the optimism of the microfinance argument is questioned as well. For example, some critics argue that the interest rate charged by MFIs is commonly

higher than commercial finance agencies (Rosenberg, Gonzalez, and Narain 2009, 148–49, as cited in Hudon and Sandberg 2013, 571). What is worse, some microfinance NPOs who are funded by government or international donors even charged double the rates of those charged by commercial MFIs (Barry 2012, 138). In addition, some critics argue that microfinance brought social exclusion to those neediest, such as widows, single mothers, or migrant laborers, since social capital is not necessarily fairly-distributed (Schurmann and Johnston 2009, 522–23). Considering the potential of better repayment capacity, people tend to form their borrower group with wealthier or more trustworthy fellow members. Likewise, due to having no supporting inputs such as land, capital, additional working family members, human capital, and knowledge of running a business, the poorer borrowers will be highly likely to receive a relatively lower rate of return. As a result, poorer-connected members tend to be socially sanctioned (See Chaves 1996, as cited in Hassan 2002, 222). Therefore, microfinance replicates existing social inequalities (Coleman 1988, 103); the access to microloans can actually increase borrowers' income inequality due to the fact that those potent members, the relatively better-educated or charismatic ones, usually control the agenda and enjoy disproportionate influence during the “democratic” process dealing with borrower group-affairs (See Mayoux 2001, as cited in Hudon and Sandberg 2013, 565). It was found by some critics that MFIs have gradually shrunk their focus on their discipline codes of conduct in order to promote profit generation (Rouf 2011b, 20–21). Considering the possibility that MFIs might choose to move their focus from the hardcore poor to those more profitable targets (Dowla and Barua 2006, 203–4), the nature of microfinance could be understood as a

mechanism of exploiting members' social connectedness (Besley, Coate, and Lounry 1993, 794).

Some critics warn that microfinance might cause borrowers to fall into the vicious circle of loan dependency. It is not necessarily the case for borrowers to be successful in their microenterprises (Hudon and Sandberg 2013, 568–69). Without significant “graduation rate,” the rate at which the self-employed build up enough wealth to start full-scale firms, borrowers might be entrapped in the loan dependency in the long-run (Ahlin and Jiang 2005, 29). Due to poor borrowers' low rate of return on their microloans, they need to borrow new loans to repay their old loans and fall victim to perpetual debt (See Ahmed 1997, as cited in Hassan 2002, 237–38). It suggests that credit alone cannot shift the problem of poverty (N. K. Shetty 2008, 88).

Moreover, some critics argue that MFIs themselves are the victim of dependency on external funding. Since most MFIs are not profitable and the income by charging loan interest is insufficient to cover their operating costs, they are actually dependent on government funding or international charities (Hassan 2002, 255–57). As an observation shows, three-quarters of MFIs were owned or funded by governmental agencies or international NPOs, who are usually politically motivated and expect their political influence in MFIs served in return (See Helms 2006, as cited in Bayulgen 2008, 529). In this sense, GB's success could be explained by the relatively loose international money supply, and today's MFIs can hardly replicate its success due to the global financial conditions changing (Gibbons 1999, para. 41).

In Leftist terms, the microfinance movement not only created an unrealistic expectation of poverty alleviation but also facilitated the transformation of global capitalism



(Fermon 1998, 129). In this sense, the primary objective of the borrower group is MFI's financial health rather than borrowers' welfare (Rankin 2001, 29). While emphasizing equal opportunity of credit as the rhetoric, what MFIs really focused on is the individual attainment of borrowers, which replicates the capitalist ideologies and practices (Isserles 2003, 43, 46). The whole microfinance system could be understood as a mechanism of accumulation by dispossession (Keating, Rasmussen, and Rishi 2010, 160).

### **Critiques: Ineradicable Gender Oppression**

Though only few, if any, critics challenge the democratic theory of gender justice, some still doubt if microfinance really brings the poor gender equality. According to this critical perspective, female borrowers will suffer more, rather than less, once joining the microfinance system. For example, married female borrowers are not only evaluated on their own merits or capabilities of repayment but also judged by their spouses' delinquent behaviors, such as drinking or gambling, which might exclude poor women from the microfinance system (Schurmann and Johnston 2009, 522). Likewise, female borrowers need to take on their husbands' responsibility of default if their husbands refuse or cannot repay (Goetz and Gupta 1996, 54). Therefore, most female borrowers are pressured from both sides (Gibbons 1999, para. 16). As an observation shows, female borrowers in Africa not only need to assume traditional obligations such as providing subsistence crops but also have to take the responsibility of providing cash for their husbands and children, since they now have their own career and income (Mayoux 2001, 451–52). Female borrowers are dominated by their spouses so deeply that they cannot actually enjoy the benefits from the financial gains of their microenterprises (Rouf 2011b, 18). As a survey of female borrowers shows, only 37 percent of female borrowers have significant

control of the usage of their microloans, while about 63 percent have partial, very limited, or no control over their microloans (Goetz and Gupta 1996, 49 figure 1). In many contexts, female borrowers defer the control of loans to their husbands or are convinced to invest their loans in male-led activities (Bayulgen 2008, 538). In addition, some critics argue that microfinance programs have little impact on female borrowers' benefits (Fermon 1998, 129). As a study of microfinance in India shows, microfinance has no discernible effect on female borrowers' education and health in the short run and has no impact at all on their empowerment in the household, even in the longer run (A. V. Banerjee et al. 2013, 34).

Since women are always idealized as “mothers” and are assumed to have more responsibility of caring for the family (Isserles 2003, 48), female borrowers are usually burdened by caring for children and the elderly, which might jeopardize their microenterprises or other income-earning activities (Bayulgen 2008, 538). Once the total workload increases substantially, many female borrowers will have no choice but to decrease their participation in local public life (Ben Hamida 2000, 8–9) or even to keep themselves away from other social and political activities (Mayoux 2005, 12). Likewise, women usually focus on the enhancement of their children's living conditions and education while their husbands usually spend their microloans on productive or capital-increasing activities (Hassan 2002, 233). As a result, female borrowers might be entrapped in the vicious circle of dependency (Mayoux 2001, 453): Due to low income and barely sustainable economic activities, once female borrowers fail their microenterprises, they will need to ask money from their husbands for their installments, which increases their dependency on their spouses and might produce new sources of tension in the household (White 1991,

30). For that reason, many critics argue that microfinance can hardly facilitate a harmonious or communicative spousal relationship. For example, Todd (1996, 212) indicated that many female borrowers overestimated the size of their economic contribution brought by MFIs in the household; in many cases, women's improved breakdown position only came at the expense of a weakened breakdown position of their husbands. Men might feel threatened in their role as the primary breadwinner in the household since they are usually excluded by many MFIs in the first place (Armendáriz and Roome 2008, 2). As a result, the rate of incidence of domestic violence attributable to microfinance increases, (Haque n.d., 60–62) and so does the likelihood of divorce (Mayoux 2005, 19).

All in all, opponents of the microfinance argument assert that MFIs did not actually engage in promoting gender equality but only provided services for their clients' profitable development (Rouf 2011b, 24). What MFIs preached is a kind of economism, instead of a politically progressive women's consciousness (Rouf 2011c, 38–39). And the whole idea of microfinance neglects the larger infrastructural conditions impinging on women's actual ability to self-sustain and only throws women into the maelstrom of the global business world (Ehlers and Main 1998, 436–37).

### **Critiques: Ethnic Conflicts and “Bad” Civil Society**

Though still recognizing its importance, some researchers indicate that the outcomes of social capital are not necessarily positive (Ito 2003, 323), nor truly a “public good” available to society at large (Foley and Edwards 1996, 41). Though voluntary associations may increase mutual trust among social members, it can facilitate rent-seeking activities as well. Dense concentrations of social capital might be highly segmented across spatial and ethnic divides. (J. Fox 1996, 1091). Relatively homogeneous associations in a

heterogeneous society may strengthen trust and cooperative norms within ethnic groups, but weaken trust and cooperation between social groups, which is highly likely to result in ethnic conflicts or civil wars (Knack and Keefer 1997, 1277–78). Ethnic conflicts may destroy physical capital, dissolve social capital, deteriorate human capital, and eventually disrupt the economy. An ethnically fragmented society might be prone to competitive rent-seeking behavior by the different ethnic groups and have difficulty providing public goods for citizens (Grootaert 1998, 17).

Civil society by nature is grounded in a certain degree of self-government, discipline, and communication, a realm that consists of power relations (Sven 2006, 142). Therefore, a dense but segregated society may or may not contribute to effective democratic governance. In order to facilitate a pro-democratic environment, voluntary associations must not be “polarized” or “politicized;” rather, they must bridge social and political divisions (Putnam 1995, 665). Increasing social capital among citizens without the sense of commonality and civilized citizenship might result in severe conflicts between social groups by using social capital to bond their in-group consolidation rather than to bridge the gap between social groups (Minkoff 1997, 609). Thus, there is no guarantee that enhancing social capital will necessarily lead to a more equitable society; the renewal of civil society and the generation of social capital within it cannot necessarily solve ethnic conflicts inside the society (Foley and Edwards 1997, 550). For example, the increasing social capital among peasants and workers in El Salvador in the 1960s and 1970s led to a growing polarization and, eventually, the upheaval of civil war (See Baloyra 1982; Stanley 1996). Likewise, civil society will be enfeebled after the transition to democracy if there are no real meaningful autonomous social groups and civilized citizens (Hadenius and Ugglå

1998, 47). For example, since the democratic elections, a significant number of non-governmental organizations (hereafter NGOs) in South Africa closed or drastically curtailed their operations (Caliguire and James 1996, 61–62). NGOs in Eastern Europe, who had helped overthrow the communist regime, gradually declined due to the whole civil society, traditions, moral norms, spirit of rule of law, and voluntary organizations being destroyed or greatly weakened after democratization (Smolar 1996, 33).

For that reason, opponents of the microfinance argument believe that the social capital that MFIs helped borrowers enlarge will eventually be tied to the political motives of international NPOs, politicians, or ethnic group leaders (Weber 2002, 541 note 32). The mechanism of social sanction adopted in the microfinance system could worsen ethnic or class cleavages. The discipline inflicted by MFIs on borrowers and the consolidation in the borrower group should be understood as nothing but a tool of manipulation. In this sense, microfinance could hardly facilitate real democracy.

### **General Discussion of the Microfinance Argument**

Theories of Economic Development and Fairness. In general, an economically well-developed country may facilitate democracy by increasing its investment in education, enhancing human resources, reforming communication technology, and strengthening the middle class. However, the country's wealth might not bring a pro-democratic environment if the wealth was built on the basis of minerals or energy. Hence, the inconsistency of the democratic theory of modernization and economic development could be seemingly found in such cases. As a study shows, countries with full civil liberties have significant economic rate of return, while the form of government alone (whether or not democratic) has limited impacts on economic development (Isham, Kaufmann, and Pritchett

1995, 27). Seemingly, what really matters in the democratic theory of modernization and economic development is how citizens become involved in the democratic process rather than whether or not they have regular election. In addition, it is well-believed, after decades of debate, that there exists an inverted U-shape curve of relationship between economic fairness and democracy: These two factors are negatively co-related before the democratization, but are positively co-related after democratization. That is, it is important for a democratic society to reduce its economic inequality and alleviate poverty in order to consolidate itself.

It might be true that MFIs usually charge relatively higher interest for their microloans, compared with traditional financial agencies. But most commercial banks only approve loans to borrowers having guarantors, collateral, or good credit history. That is, MFIs might be the only source where the poor are able to obtain loans. In addition, as a matter of fact, the interest rates that most MFIs charge are usually lower than usual credit card interest rates (Hudon and Sandberg 2013, 571) or the consumer credit rates those formal financial agencies charge (Rosenberg, Gonzalez, and Narain 2009, 152–53). Conversely, even the relatively “high” interest rates charged by MFIs could only cause “little” financial burden on borrowers due to the affordable amount of installments (Gibbons 1999, para. 71). In addition, the nature of microloans, that are intentionally designed to be repaid in small installments every week, helps borrowers accumulate precious capital since they can repay from their income flow (Hossain and Diaz 1997, 108).

It might be true as well that group lending would sometimes exclude the poorest group in society. However, the project for struggling members in the G2 system that has existed since 2000 shows the possibility of social inclusion that MFIs have the potential

to facilitate. As studies show, the poorest are still willing to be financially and eventually socially re-included, with microfinance's help and under no peer pressure (Dowla and Barua 2006, 261–62; S. R. Khandker, Khalily, and Khan 1995, 59), which lead them to higher levels of political awareness and participation as well (Schurmann and Johnston 2009, 521–22).

It might be true that some borrowers could fall into loan dependency due to their low rate of return. However, the average rate of return of microloans in most MFIs is notably high. For example, the rate of return on investment of borrowers in CARD Bank in the Philippines is estimated at 117 percent; a single unit of CARD-microloan can generate three-point-zero-three times of gross income (Hossain and Diaz 1997, 103, 111–12). As studies of microfinance in India and Kenya show, the rates of return are even higher than the case of CARD-microloans (See Harper 1998, as cited in Gibbons 1999, para. 72). In addition, most of those MFIs whose members have low rate of return did once enjoy a period of high rate of return in the beginning stage. The rate of return of an MFI, after all, is highly related to the macro economic performance of the society. An upward shift in the labor demand curve is required for both improved productivity and wage gains on a sustainable basis, which calls for a structural transformation of the rural economy (S. R. Khandker, Samad, and Khan 1998, 96). For most developing countries, the key to the success of poverty alleviation is growth and productivity potentials in the economic sector, which is highly dependent on productivity increase and technological change. What MFIs can help, at best, is only to increase employment and production on the existing level of technology (S. R. Khandker, Samad, and Khan 1998, 122). It would be unrealistic and unreasonable to criticize MFIs for not helping level up borrowers' production

technology. The level of a society's production technology is usually related to the level of capital investment, which requires efficient institutions; laws and regulations protecting property rights are especially crucial to economic growth and investment (Knack and Keefer 1995, 223). Part of the reason why developing or under-developed economies suffer stagnant growth is related to the fact that their governments did not efficiently play their economic role in protecting property rights and managing economic externalities (Grootaert 1998, 16). Though microfinance has nothing to do with law-amendment directly, it can still promote a transparent and pro-democratic set of institutions indirectly by enlarging borrowers' social capital, enhancing their citizenship, and facilitating their democratic participation. With microfinance's help, it will be easier for the poor to be organized and mobilized in order to take collective actions and make their voice heard in the political arena (Berger 1989, 1019).

It might be true that MFIs could be dependent on government funding or international charity. For MFIs, the available alternative sources of funds might be members' savings, stockholders, or interbank positions, which require the authorities to amend the regulations and treat them as formal financial agencies, which is not something MFIs can decide. As a matter of fact, there are more and more MFIs trying to reduce their dependency on external funding by engaging in saving business or releasing their stocks to the open market or borrower members. In addition, there are more and more MFIs trying to enhance their profitability in order to make themselves commercially sound (Gibbons 1999, para. 40). But this solution suggests as well that MFIs will have less tolerance to borrowers' default or late repayments. In order to keep MFIs from becoming voracious big companies, the idea of social enterprise could be the way out of this predicament; it



depicts a double bottom line to achieve a productive balance between mercenariness and unselfishness (Woller, Dunford, and Woodworth 1999, 55).

It might be true that microfinance eventually brings a pro-capitalist environment. However, as Weber (2001, 8) pointed out, microfinance has the capacity to perform a “dual function” in the global political economy: On one hand, microfinance facilitates global financial integration and extends the network of financial services to the local level. On the other hand, microfinance helps build a political safety net and offset income insecurity by absorbing surplus rural labor in growing informal sectors. Though microfinance seemingly worsens the disadvantages of global capitalism, it cultivates the resistance to the invasion of the Neo-Liberalist world order by enlightening the poor with financial and business skills, by consolidating isolated individuals with self-help/mutual-help groups, and by turning those excluded into empowered citizens. Without microfinance’s help, the poor have no choice but to depend on the limited options handed out by the government or big companies.

Theories of Gender Justice. Most criticisms against the democratic theory of gender justice focus on whether or not microfinance is really advantageous to promoting gender justice, rather than on the theory *per se*. Though critical cases of MFIs, such as what Banerjee et al. (2013) found in India, seemingly contradict the democratic theory of gender justice, it might be seen as an exception rather than the general case. As a matter of fact, misconduct or misregulation among MFIs operated in India has often found. For example, the Indian authority once significantly intervened the operation of local MFIs in 2006 (See Duflo and Walton 2007). In addition, there still are multiple empirical studies of microfinance in India supporting the democratic theory of gender justice. For example,

Reddy and Manak (2005, 3) found female borrowers' economic, social, and political status was significantly improved under microfinance's help. Likewise, Bali and Yang (2009, 541) found that female borrowers were significantly empowered while there was no discernible change in the control group.

It might be true that those counterexamples of microfinance in India imply the invalidity of the microfinance argument, but the factor of gender inequality is hardly the sole cause. In another study of microfinance in India, Leach and Sitaram (2002, 575) indicated that even if microfinance helped overcome men's hostility, women's microenterprises were unlikely to have been viable commercially. However, they (2002, 575, 584–85) also admitted that the imperfect outcome of microfinance should be attributed to borrowers' lack of necessary skills (such as literacy) or basic financial knowledge (e.g. some borrowers misunderstood those loans as their wages paid by MFIs). Microfinance alone cannot overthrow the structure of gender inequality in developing countries. As Mayoux (1995, 56) indicated, if the structure of gender inequality remains, microfinance may only increase women's workload and responsibilities without increasing the income they can control. However, microfinance is nearly the only feasible production option for poor women in developing countries (Ehlers and Main 1998, 436–37). The undeniable fact is that women can more or less benefit from the structural change in the long run through the enlarged social capital, organized collective actions, and empowered political engagement brought by microfinance.

Theories of Social Capital and Civil Society. Theoretically, the mechanism of social capital, at the macro level, needs the existence of well-accepted social norms and a social structure with a closure as its prerequisites in order to limit negative external effects and

encourage positive ones. (Coleman 1988, 105–6). That is, the mechanism of social capital, by nature, tends to cause conflicts between social groups, unless there exists a platform of common good and public morality; the advantage of social capital facilitating in-group consolidation will be totally countervailed by the disadvantage of conflicts between social groups. In that case, social capital will be productively meaningless. For that reason, citizens need to be educated in civil society and learn to deal with pluralistic conflicts (Helmich and Lemmers 1998, 14). In civil society, norms provide citizens explicit guidelines of how to behave. Citizens need to be “civilized,” to consider others as fellow citizens of equal dignity in their rights and obligations (Shils 1991, 12–13), and learn to co-exist harmoniously with other citizens (Hall 1998, 32). If citizens are unable to internalize codes of public morality or self-discipline, civil society can hardly exist (Ossewaarde 2006, 207).

In this sense, civil society can never be separate from the state. Though civil society incorporates, it cannot dispense with the state (Walzer 1991, 8). The state can never replace civil society, nor the other way around (Lehning 1998a, 241–42). The state and civil society can be mutually reinforcing through their common support for the legitimacy of the state’s rule (Lehning 1998b, 37). For a long time, civil society has been misleadingly credited with the political peace, which is actually maintained by the state (Foley and Edwards 1996, 47). Citizens need the state institutionally to protect their civil rights and fulfill their basic needs (Shils 1991, 4).

In almost every case, people are members of civil society and citizens of the state at the same time (Alexander 1994, 21). It is such dual membership that makes civil society a porous public sphere where citizens are able to sublime themselves from dilettantism to

excellence, under protection from the state (Alexander 1997, 129). On the other hand, citizens need to learn knowledge of justice and public morality from the state (Walzer 2011, 74), especially from how the state legally behaves and how it justifies its legitimacy. What goes in the realm of the state will eventually be reflected in the realm of civil society (Gamm and Putnam 1999, 553). In addition, the formal institutional structure of a society demonstrates the trustworthiness of social norms for citizens all the time. Citizens can learn to trust each other by trusting in institutions and social norms in the first place; as a study shows, countries with formal institutions effectively protecting citizens' fundamental rights provide a more conducive environment to cultivate mutual trust and cooperation (Knack and Keefer 1997, 1279).

In a democratic society, social groups must keep themselves “moderate” and restrained in whatever they demand; they must not reinforce social cleavages and conflicts but bridge them by communicating and cooperating with the others; they must insist to be institutionalized as part of the social organism; they must cherish and treat democratic spirits as the “first cause” in a pluralistic world (Foley and Edwards 1996, 47 note 21). That is, civil society needs a liberal constitutional democracy, which is the only known political system capable of co-existing with a multiplicity of cultures and ethnicities, as its prerequisite (Lehning 1998b, 28–30). A strong civil society has to be strong in protection of citizens' basic needs and interests, i.e. fundamental rights in defense of civil society's self-governance and independence (Alexander 1994, 45). It refers to what Walzer (1991, 9) called the paradox of the civil society argument: civil society requires political agency, the democratic state, as its premise in the first place, and civil society strengthens democracy in return.

Civil society thereby appeals to a compound of public philosophy, which is capable of simultaneously covering voluntariness, reason, cooperativeness, and civility. And liberal democracy is exactly the starting point for this purpose (Kymlicka 1997, 86). After all, even the most self-interested transactors care about being treated fairly and treating others fairly, and are willing to resist unfair players even at a positive cost (Kahneman, Knetsch, and Thaler 1986, 299). A fair procedural institution will encourage social members to defer to the authorities, act on behalf of groups they are affiliated with, and remain within the community (Tyler 1999, 222). With the help of procedural democracy, civil society will be a real forum, a setting of settings (Walzer 1991, 5–6), and therefore a “free school” of public philosophy (de Tocqueville 1898, vol. 2 page 142).

On both the theoretical and the empirical level, microfinance is able to enlarge the poor’s social capital and help civil society flourish. The enlarged social capital that is brought by microfinance helps the poor become empowered. The self-discipline imparted through microfinance helps the poor participate in public life while respecting pluralistic ethnicities, cultures, and religions. Most values microfinance promotes are not only compatible with but also complementary to democratic spirits. Though it might be true that microfinance has nothing to do with directly forging a democratic environment in the first place, microfinance can facilitate the consolidation of democracy once the democratic regime and the primary constitution have been established.

## Conclusion

This thesis theoretically reviews the microfinance argument. This thesis dialectically exams the fundamental idea of the Grameen experience, the prototype of modern microfinance, and analyzes the theoretical foundations of the microfinance argument. As this thesis analyzed, MFIs' core objectives are to convert their borrower members into social, law-abiding, and cooperative modern citizens, by intensifying their in-group identity, providing various group benefits and welfare services, and creating a member-based virtual public sphere. In this realm MFIs forged, microfinance borrowers are able to cooperate socially, economically, and politically; they are able to sublime their personal life, social life, and economic life into political life; they are able to achieve themselves in the way of being a moral agent living in the public realm. As a result, the once excluded underclass become democratic participants by equipped themselves with their experience of microfinance.

At the macro or collective level, this process of turning borrower members into modern citizens would be accompanied with economic development and redistribution of wealth. As many empirical observations suggested, the microfinance practice is related to economic development and equality. Meanwhile, as other researchers suggested, economic development and (in)equality are highly related to democratic development. As a result of logic, democracy could be seen as the concomitant of microfinance.

Likewise, this process of democratization of microfinance would be accompanied with the enhancement of gender justice, the accumulation of social capital, and the vitalization of civil society. As observations pointed out, microfinance significantly, helps microloan borrowers accumulate and reproduce their social capital, empowers female par-

ticipants and improves their financial, economic, and political conditions, and emerges and consolidates civil society. Consider the theoretical connections between social factors, such as gender justice, social capital, and civil society, and democracy, it is accordingly reasonable to see democracy as the concomitant of microfinance as well.

With microfinance's help, the poor not only obtain financial capital, but also grasp the opportunity to be re-included into the mainstream of global society. By providing financial services, MFIs fulfill the poor's basic needs and empower them in their everyday life. With MFIs' help, microloan borrowers gradually equipped themselves with knowledge and skills of finance, production, economics, health, and public affairs, which are exactly what modern citizens need while participating in the democratic life. Though microfinance can hardly make the institutional or constitutional democratization happen in the first place, which is definitely unreasonable to be expected, microfinance does have the potential to facilitate the consolidation of existing democracy, as this thesis argued.

However, this process of democratization of microfinance is not straightforward or irreversible. Traditionally, democratization is initiated by political elites in the governmental sector. The outcomes of democratization therefore are ineluctably submitted to the will of superpowers or influenced by internal ethnic cleavages. As a result, most democratic regimes in developing areas were established without fulfilling the prerequisite conditions such as a public philosophy pursuing the common good, the spirit of rule of law and constitutionalism, protection of property and civil rights, an emerging middle class, a strong and flourishing civil society, and an institutional, social, and cultural remedy for class conflicts, gender inequality, ethnic oppositions. Microfinance can only rest its success on the enlarged civil society, enhanced human capital, trustworthy institutional

systems, and civilized pluralistic participation; so does democracy. Therefore, microfinance could be a useful tool to facilitate democratization and consolidate existing democracy, although its positive outcomes might not be necessarily expected in the short run, while negative results might be highly likely to be observed.

### **Implication of This Thesis**

Having regular elections alone is not necessarily a real meaningful democracy. Democracy needs citizens' substantial participation, which requires a more economic, social, and political inclusion as the precondition. If the consolidation of democracy had been facilitated by microfinance, a more efficient, transparent, and participatory democratic society would have been established more easily and the outcome of democratization would have lasted longer and been more peaceful. In that sense, microfinance could not only be connected to democracy, but also facilitate, strengthen, and consolidate it.

Nevertheless, what this thesis has contributed is a preliminary effort to clarify the theoretical delicacies about the democratization of microfinance. This field still calls for follow-up research works, especially empirical studies, to provide supportive evidence for the microfinance argument. For that goal, this thesis has provided a comprehensive theoretical framework for future researchers. The five theories introduced in this thesis could respectively be a single model of empirical analysis. Based on whether local, national, or international data, future researchers can test the causal relationships of variables among these five theoretical models. Beyond that, future researchers are able to develop a multivariate model consisting of these five theoretical constructs as well to evaluate the actual impact of microfinance on democracy. Whether to test the statistical relationship between variables in various models, or to fill in blind spots of understanding



with deep narratives or case studies, the theoretical framework provided in this thesis could be the first step of the ground. Although it might not for this thesis to be an irreplaceable vanguard or pioneer of the democratic research of microfinance, this thesis can still contribute to the academia by showing a plausible theoretical explanation of the microfinance argument.

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