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A new Balkan tragedy? The case of microcredit in Bosnia

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*“The microcredit lobby got poverty wrong: it is not about supply, it is about demand”, argues **Milford Bateman**, Visiting Professor of Economics at the University of Juraj Dobrila, Pula, Croatia. The results of Bateman’s research were presented at the second [conference](#) of the LSEE Research Network on Social Cohesion in SEE.*

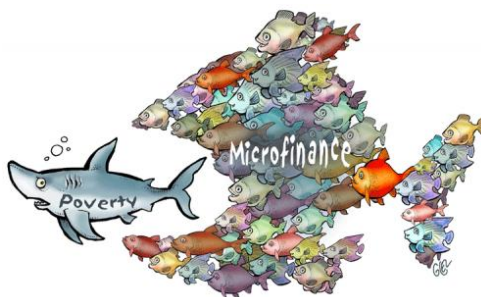
The end of the Yugoslav civil war in late 1995 saw the international development community arrive in Bosnia to help reconstruct a shattered newly independent country. One of the standard neoliberal policy interventions demanded of the new Bosnian government was the concept of microcredit; the provision of small loans – microloans – to facilitate the establishment of informal microenterprises and self-employment ventures. The international community was in very firm agreement that microcredit would generate a powerful bottom-up impetus behind reconstruction and development in Bosnia. Massive amounts of international aid were soon forthcoming to get a microcredit industry started. By 2009, Bosnia possessed one of the most extensive microcredit sectors in the world, second in per capital penetration only to the iconic home of microcredit – Bangladesh.

Microfinance penetration by country (and region) in 2008

<i>Global Ranking</i>	<i>Country</i>	<i>Borrower accounts/population</i>
1	Bangladesh	25%
	(Andhra Pradesh State, India)	16%
2	Bosnia and Herzegovina	15%
3	Mongolia	15%
4	Cambodia	13%
5	Nicaragua	11%
6	Sri Lanka	10%
7	Montenegro	10%
8	Vietnam	10%
9	Peru	10%
10	Armenia	9%

Microcredit advocates soon began to claim that ‘hundreds of thousands’ of new jobs were being created. Then President of Women’s World Banking, [Nancy Barry](#), was sufficiently confident in the progress being made to make the claim that “any war-torn country should look to Bosnia as a role model”.

The world gets excited about the supposed power of microfinance...



...but it’s all based on mistaken claims

Unfortunately, all of these claims for positive impact are mistaken. In fact, the sour reality that we must now face up to today is that the microcredit experiment in Bosnia has been an outright calamity for its people. So what happened? Several inter-

related negative impacts help to account for what transpired. First, we need to note right away that almost all of the microcredit provided in Bosnia actually [went into consumption spending rather than into stimulating investment](#) in new and expanded microenterprises. Unfortunately, this substitution of debt for non-existent income led to very many poor individuals beginning a journey into deep and irretrievable 'microdebt', a process not helped at all by high real interest rates charged by increasingly commercially-minded microcredit institutions (MCIs). When in 2009 Bosnia's microcredit experiment turned from boom to bust, the problem of over-indebtedness had reached a crescendo.

From poverty into debt

For example, [it was found](#) that 28% of all MCI clients were found to be '*seriously indebted or over-indebted*', of which around three-fifths of these were in a situation where their monthly repayment *exceeded* their total household disposable income. Nearly 60% of borrowers were found to have more than one microcredit account outstanding, with a full 9% having more than five microcredit contracts outstanding. Also found to be in deep trouble were the more than 100,000 individuals in Bosnia who, perhaps unwisely, agreed to guarantee one or more microloans for family and friends. These guarantors – often in similar depths of poverty as those they guaranteed – [are now being pushed hard](#) for repayment on the microloans they guaranteed. To put it mildly, this was not poverty reduction so much as a descent into 'microdebt peonage'.

Supply does not create its own demand

The second problem encountered here centres on a continuing belief in 'Say's Law', the long debunked economic idea that 'supply creates its own demand'. Even today, this false notion [bedevils](#) those development economists with a concern to address poverty, unemployment and under-development. The late [Alice Amsden](#) brilliantly pointed out that a widely mistaken belief in 'Say's Law' has effectively led to the non-performance of virtually all supply-side programs undertaken by the international development agencies. Nobel Economics prize winner, [Amartya Sen](#), also effectively debunked 'Say's Law' when revealing that famines are caused not so much because of a simple lack of food availability, but because the poor simply do not have sufficient purchasing power to buy into the *available* (often adequate) food supply.

Unfortunately, a continuing belief in the validity of 'Say's Law' has created an immense problem for the microcredit model. Belief in 'Say's Law' is directly traceable back to the iconic founder of the modern microcredit industry, 2006 Nobel Peace Prize laureate, Dr Muhammad Yunus. Yunus's misunderstanding here is on record with his famous [claim](#) that:

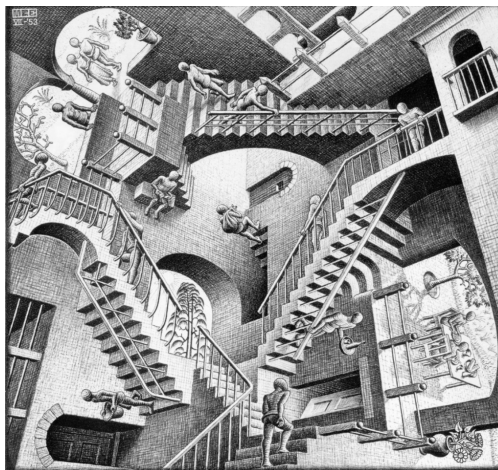
[a] Grameen-type credit program opens up the door for limitless self-employment, and it can effectively do it in a pocket of poverty amidst prosperity, or in a massive poverty situation."

As a result, very many microcredit advocates were led by Yunus to believe that there is an infinitely elastic level of local demand that will always be sufficient to absorb the expanding output of any number of local microenterprises. Thus, simply expanding the supply of microcredit, in order to expand the supply of informal microenterprises and self-employment ventures, the argument runs, can only ever end up creating plentiful number of new jobs. This is almost entirely wrong. In fact, of that small percentage of microcredit that actually goes into business investment, it is simply *not* the case that a sufficient level of local demand always exists to absorb the very simple items and services eventually produced. Instead *job displacement* and *exit* effects greatly undermine microcredit and microenterprise programs. Thanks largely to an economically unproductive and financially wasteful local process of 'job churn', the end result of most microcredit programs is typically almost no NET employment creation.

Nothing more than local job churn in Bosnia too

Standard 'job churn' effects were very quickly experienced in Bosnia. First, many microenterprises struggling to operate prior to the arrival of the microcredit industry (and even before the war), were immediately plunged into vicious competition with rafts of new microcredit-assisted microenterprises operating in their sub-sector. Displacement effects inevitably arose, with the result that almost as many existing jobs in microenterprises were being killed off as were supposedly being created in new microcredit-assisted microenterprises. Second, many new and incumbent micro-entrepreneurs were unable to survive in the increasingly over-crowded market, thus leading to very high rates of exit. Accumulated income, savings and other assets were then lost as outstanding microloans nevertheless still had to be repaid. Taking both effects together, the end result in Bosnia of the arrival of microcredit was very little NET sustainable employment growth or average income growth. This probably helps to account for why Europe's most extensive microcredit sector co-exists alongside one of Europe's persistently highest unemployment rates ([almost 46%](#)).

We find only the appearance of unending job creation



M. C. Escher – Relativity. From images.cdn.fotopedia.com

Local solidarity, mutual support and trust are generally destroyed

Third, one of the most disturbing developments in Bosnia was the massive salaries and bonuses packages self-awarded to senior MCI staff in Bosnia, allied to asset-stripping practises. Large financial returns were also enjoyed by the many external funders and investors working with Bosnia's MCIs, many of which were based in Switzerland, Holland and other low-tax regimes. It soon became abundantly clear to most people in Bosnia that microcredit was all about enriching the *providers* of microcredit, who were getting spectacularly rich, and not the *recipients*, who largely remained as much in poverty as before. It didn't help at all when several institutions not only refused to condemn such egregious practices, but continued to warmly welcome to their prestigious events the main CEOs most directly involved. This sent out a very powerful signal to all MCIs in Bosnia, and in [neighbouring regions](#) too, that high salaries/bonuses and asset-stripping would largely be tolerated by the international community. All told, Bosnia's wave of '[control fraud](#)' has directly helped to destroy remaining reserves of trust, reciprocity, mutual support and solidarity, intangible factors that are absolutely vital to further reconciliation and sustainable development.

Gender *dis*empowerment

Fourth, one of the abiding myths used to justify the expansion of microcredit in Bosnia, and everywhere else around the world, was that it would lead to a major episode of 'gender empowerment'. Bosnian women were told they had the power to transform their lives, and should waste no time in using a microcredit to better themselves. This was utter nonsense. A lottery ticket has the *potential* to be empowering only if it turns out to be a winning ticket, but since the vast majority are *not* winning tickets, the result is simply a transfer of resources over from the poor to the rich owners of the gambling organisations. Similarly with microcredit: we know that the vast majority of new businesses fail, *especially* involving women (for a number of reasons), and so there is little real empowerment enjoyed in practise. Even worse, in the few cases of 'business success', these very often involved nothing more than women entering simple street trading, handicraft production, primitive agriculture (keeping a cow in the back garden) and so on. Bosnia's women greatly resented the fact that they were effectively being forced into surviving by going back to the sort of primitive occupations they thought had been left behind in the mid-1900s. This was certainly not what they thought the transition from Yugoslav-style communism to capitalism would entail.

Pointedly, the most powerful evidence of gender *dis*empowerment is actually provided by the only women-only MCI in Bosnia – *Žene za Žene* (Women for Women). Encouraging its women clients to enter into the usual manifestly unsustainable business areas, *Žene za Žene* was eventually forced to close down after more than 4,000 of its defaulting women clients defaulted and were forced to go through the Bosnian courts, as is the norm, to formally declare that they were bankrupt and could not repay their microloan. One struggles to conceive of a more disempowering life event for those women involved. Let us be quite clear here: it is the *market* that is being empowered by microcredit in Bosnia, not *women*.

Bosnian women were largely plunged into unrepayable debt thanks to their engagement with microcredit.

Microenterprise development does not equal sustainable development

The final problem here is perhaps the most important one: sustainable development is simply not associated with the expansion of the informal microenterprise sector, *and is likely undermined by it*. Economic history actually [shows](#) that sustainable development requires that scarce funds be directed towards the *highest productivity* applications, such as businesses above minimum efficient scale, using some technology, require higher levels of skill, and so on, and not towards the *lowest productivity* (no growth) applications, which overwhelmingly involve the sort of informal microenterprises and self-employment ventures supported by microcredit. To the extent that the microcredit industry in Bosnia has channelled its scarce financial resources into such unproductive areas, therefore, the long-run development potential of the country has effectively been destroyed. Microcredit in Bosnia, as everywhere else has [ended up](#) achieving nothing more than the deindustrialisation, primitivisation, disconnection and informalisation of the local economy.

Microcredit has been a 'sub-prime' episode in Bosnia's history

Give a woman a microcredit loan to buy a fishing boat and the CEOs of the microfinance institutions and the microfinance investment funds will eat for a lifetime.

Hugh Sinclair, COO of a microcredit institution in Ecuador and author of 'Confessions of a Microfinance Heretic'.

Thanks to microcredit, Bosnia was to experience its own US-style 'sub-prime' episode, an episode that saw the main beneficiaries to be a small elite working in and around the main MCIs. An explanation for the continuing popularity of the microcredit model in spite of its manifest failure everywhere, very much including in Bosnia, thus lies within the politics of development, and particularly the well-known desire on the part of business and political elites to continue forward with destructive neoliberal policies that they have magnificently benefitted from at the direct expense of the poor.

To find out more, you can access the full paper "How to destroy an economy and community without really trying: The rise and fall of microcredit in post-conflict Bosnia" by Milford Bateman, Dean Sinković and Marinko Škare [here](#).

Note: This article gives the views of the author, and not the position of LSEE Research on SEE, nor of the London School of Economics.

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