YUSOF ISHAK INSTITUTE

ISSUE: 2020 No. 134

ISSN 2335-6677

PERSPECTIVE

RESEARCHERS AT ISEAS – YUSOF ISHAK INSTITUTE ANALYSE CURRENT EVENTS

Singapore | 25 November 2020

Microcredit in Cambodia: Why is There So Much Support for a Failed Poverty Reduction Model?

*Milford Bateman**

EXECUTIVE SUMMARY

- Cambodia's microcredit sector – the world's largest (in per capita terms) and most profitable – has created a raft of negative economic and social phenomena that are increasingly undermining the functioning of the economy and cohesiveness of society.

- Three especially damaging trajectories associated with Cambodia's microcredit sector are:

    - a 'no-growth' low productivity economic structure built on an 'extractivist' logic;

    - reckless lending strategies that have created dangerous levels of over-indebtedness in the poorest communities; and

    - the widespread use of land titles as collateral which has inevitably led to the growing loss of land by the poor through coerced informal sales.

- The Covid-19 pandemic may require the government to bail-out struggling microcredit institutions in Cambodia. A logical, pro-poor way forward would be to make such bail-outs conditional upon an agreed conversion of existing privately/foreign owned microcredit institutions into local community-owned and controlled financial ones. Debt-for-equity swaps would be one way to achieve this goal.

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INTRODUCTION

The microcredit model is a financial innovation that, since the 1980s, has been very widely promoted in the Global South to combat poverty, joblessness, inequality and gender disempowerment. In microcredit, tiny loans or 'microloans' are used to establish or expand an informal microenterprise or self-employment venture. There was much initial optimism from practitioners in the field and the idea seemed to be very solidly backed by rafts of impact evaluations (see Odell, 2010). Economic studies by high-profile economists (for example, see Beck, Demirgüç-Kunt, and Levine, 2007) also sagely pronounced that microcredit was a really efficient way to address poverty. By the mid-2000s Bernd Balkenhol, Head of the ILO's Social Finance Program, felt able to report that the microcredit model was now very widely accepted as "<u>the</u> strategy for poverty reduction *par excellence*" (Balkenhol, 2006, 2 - underlining in the original). However, more recently, researchers digging deeper into the evidence of a positive impact from microcredit have found that a large part of the supporting evidence relied on simplistic 'before and after' impact evaluations that ignored important wider downside factors and externalities, and so inevitably distorted the results to the upside (Duvendack *et al.,* 2011).

Abhijit Banerjee, Esther Duflo (the 2019 Economics Nobel co-recipients) and their collaborators have played a major role in evaluating the impact of microcredit. Their many early impact evaluations from 2003 onwards used the supposedly 'gold standard' Randomised Control Trial (RCT) methodology and all appeared to confirm that microcredit was having a generally positive impact. From around 2010, however, a number of independent analysts began to challenge the robustness of these results (see Bateman, 2010). To settle the issue once and for all, Banerjee and Duflo initiated a major six-country RCT-based study on microcredit impact. This study demonstrated that microcredit had almost no impact on poverty, concluding that "the studies do not find clear evidence, or even much in the way of suggestive evidence, of reductions in poverty or substantial improvements in living standards" (Banerjee *et al*., 2015:13). More recently, however, Bédécarrats, Guérin, and Roubaud (2020) found that for various reasons, Banerjee and Duflo's six country studies *still* over-stated the impact of microcredit, possibly quite considerably. In fact, had many key negative factors *not* been willfully ignored in Banerjee and Duflo's six country studies, as Bédécarrats, Guérin, and Roubaud (2020) point out, their ultimate results might have suggested that microcredit was *undermining* the economies and lives of the poor. Such a result would have confirmed what many of the harshest critics had long argued (see Bateman, 2010; Bateman and Chang, 2012; Mader, 2015).

Despite such growing reservations and extended debates about the power of microcredit to address poverty, the industry has grown significantly in some Southeast Asian countries. This essay critically examines the experience of one such country – Cambodia – which has the largest microcredit sector in the world (in per capita terms).

THE RISE AND FALL OF MICROCREDIT IN CAMBODIA

Since the early 2010s, even a cursory examination of the evidence reveals that the raft of CEOs, senior managers, shareholders, investors and individual advisors attached to Cambodia's microcredit sector have enjoyed high, and sometimes quite spectacular,

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financial rewards (Bateman, 2019a). That microcredit could be extremely profitable was first confirmed by the first foreign investments in ACLEDA's equity, which generated a huge return for the investor (*ibid*: 185). In recent years, the financial returns derived from Cambodia's microcredit industry have risen to world-beating levels. The latest example of extreme profiteering is that of the Sri Lanka-based investor LOLC which registered a near $US300 million profit in 2020 from the $US603 million sale to a South Korean bank of its 70% equity holding in PRASAC, *most of which was acquired only two years earlier* (Gamage, 2020). For a narrow global financial elite, therefore, there can be no doubt at all that engaging with Cambodia's microcredit sector has proved to be a quite remarkable success story. However, the same beneficial outcome simply does not apply to Cambodia's poor.

First, the rising supply of microcredit has undoubtedly increased the number of new microenterprise start-ups, suggesting that new jobs and incomes streams have been created. However, most new starts do not survive for long in the highly competitive local markets that exist in Cambodia, notably in retail, street food and personal transport. Many also rack up further debts in a desperate attempt to keep going (see next point). Moreover, new entrants also push out of the local market many existing microenterprises that are only just managing to survive. The inevitable end result of new microcredit-enabled entrants is thus not so much sustainable employment growth, but what economists term 'job churn' - a quite unproductive process that tends to underpin the intensified exploitation and impoverishment of the poor. One reflection of this trajectory in its worst guise is the predictable fall in informal sector incomes across a range of easy-entry activities undertaken by Cambodia's poor (see National Institute of Planning and Ministry of Planning, 2015), as well as an increase in the hours worked in many sectors in order to generate a minimum of income upon which to survive (Mendizabal *et al*., 2012: 106).

A perhaps even more important aspect of this job churn phenomenon is its contribution over the longer-term to weakening the overall structure of the Cambodian economy. Since the mid-2000s, a large amount of scarce finance has gone into expanding Cambodia's 'no-growth' informal microenterprise sector, which inevitably meant less funding available to underpin the growth-oriented formal small and medium enterprise (SME) sector, which barely grew as a result (see Bateman 2010: 101-2). More recently, the World Bank (2016: 10) highlights in its Enterprise Survey series another problem raised by Cambodia's SME managers: that growing competition from the microcredit-fuelled expansion of informal microenterprises is serving to 'crowd out' of the product market the slower-growing but ultimately more productive formal SMEs sector. Using the 'advantages' of informality (avoiding taxes, paying lower wages, etc) to grab small slices of demand from more productive formal SMEs (even if just temporarily), the growing informal microenterprise sector inevitably reduces the ability of formal SMEs to carefully plan for steady growth by investing in new technology, innovation and an eventual entry into higher value-added markets. The result is a much weaker and far less growth-oriented economic structure in Cambodia and, inevitably, higher poverty levels when compared to neighbouring more growth-oriented Southeast Asian countries.

This unfair competition angle is also exacerbated as a result of the significant profits reaped in the business of microcredit that are not being reinvested or recycled locally. Instead, these profits are siphoned out of the poorest communities in Cambodia and increasingly, if not

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largely, now sent abroad to wealthy investors. This constitutes a form of 'extractivism' that quietly drains the poorest communities of their wealth and thus, as history and recent practice abundantly shows (Guinan and O'Neill, 2019), makes it much more difficult for the local business community to flourish and the wider community to escape poverty and deprivation. Moreover, there is a real possibility that this 'extractivist' process will be significantly extended in the near future thanks to the arrival in Cambodia of 'fintech' (financial technology) and with it a new form of 'digital extractivism'. Thereafter, every single financial transaction involving the poor (obtaining credit, making purchases, money transfers, receiving government payments, etc) will involve a payment to the private fintech sector, which is likely to increase over time. This will allow for the accumulation of even *more* value, and the poorest individuals will eventually find themselves at the mercy of wealthy local and global investors and digital payments corporations.1

A second pressing problem in Cambodia is the dramatic rise of reckless lending by virtually all of its leading MCIs, which has resulted in dangerous levels of over-indebtedness in nearly all of Cambodia's poorest communities. This issue was first flagged in a study by Liv (2013) who found serious pockets of over-indebtedness across Cambodia. The ADB (2014: 14-15) then reported that this problem was almost certainly much larger since, for shame and humiliation reasons, much of it went unreported. One of the main driving factors behind rising over-indebtedness in recent years is a Wall Street-style 'extend and pretend' policy that appears to have been adopted by many of the largest MCIs in Cambodia. This involves keeping existing clients on an indefinite debt treadmill by constantly rescheduling existing microloans into the future, ensuring that they are always larger than before, but lengthening the term so as to ensure the installment payment is kept to roughly the same manageable level. In 2017, for example, the Credit Bureau of Cambodia (CBC) confirmed that "50% of loans disbursed (..) were for refinancing, with 25% refinanced earlier than maturity and 30% refinanced at over 130% of the original loan amount" (reported by Incofin, 2018). Many investors became increasingly uneasy at such tactics. As a result, a major report was urgently commissioned on their behalf by Germany's development bank (KfW) and the German Federal Ministry for Economic Cooperation and Development (BMZ), the aim of which was to explore the problem of rising over-indebtedness (see MFC, CBC and Good Return, 2017). Its key findings were quite shocking, among other things confirming that over-indebtedness had indeed been increasing quite significantly. (A fear of spooking investors with such bad news saw a determined effort being mounted to ensure that this report remained strictly confidential).

As the history of the US sub-prime crisis amply demonstrated, flooding the poorest communities with growing volumes of expensive debt can continue for quite a long time but eventually, unless concrete action is taken in time, the market must implode. With such fears in mind, in 2016 the Cambodian government resolved to do something in order to avert just such an outcome. An interest rate cap was introduced in early 2017 to slow down the growth of household debt and also, secondarily, to temper the extent of profiteering by many of the leading MCIs and their investors. However, the leading MCIs disdainfully circumvented the measure by quietly imposing a new range of fees and charges on clients. As a result, growth in microcredit volume not only continued (in 2018 at a record 30 per cent), but profits were even higher than before. Today, leading debt analysts are clear that Cambodia is the world's most microcredit-saturated country, with the level of household over-indebtedness in the very highest risk category (MIMOSA, 2020).

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The final problem with microcredit is an almost unique one to Cambodia. More than in any other country in the Global South, land titles are now universally demanded by MCIs in Cambodia as the required collateral on a microloan. While a legal process viewed by institutions such as the World Bank as a major advance for the poor (Deininger, 2003), the use of land titles to underpin access to credit has actually led over time to a major setback for the poor—the loss of their land. An MCI's clients getting into repayment difficulty in Cambodia are now routinely pressured and coerced into selling their land, often at a low price, in order to repay any outstanding balance (Licadho and STT, 2019). Indeed, it is simply the *fear* of losing one's family land that has forced many MCI clients that find themselves in difficulty not only to agree to constantly reschedule their microloans into even larger ones, as noted above, but also to return to the local loan shark for immediate cash to continue paying their installments (Ovesen and Trankell, 2014; Blomberg and Dara, 2020). Pointedly, such desperate fallback strategies to retain one's family land help also account for why, in spite of a world record level of over-indebtedness, the non-performing loan (NPL) rate remains extremely low in Cambodia. Going further, researchers have also found important links between the fear of losing one's family land and the adoption of even more risky and ultimately damaging survival tactics by Cambodia's poor. This includes taking on even *more* debt collateralized by family land in order to migrate to work in the informal sector in Thailand (Bylander, 2014), and, perhaps worst of all, being forced into 'debt slavery' in Cambodia's infamously exploitative brick kilns (Brickell, Parsons, Natarajan, and Chann, 2018). It is ironic that an intervention introduced in Bangladesh in the 1980s to primarily benefit the landless poor is now, in Cambodia, steadily *growing* the population of landless individuals.

MISPLACED SUPPORT FOR A FAILED DEVELOPMENT INTERVENTION

A central theme in economic history recently re-emphasised by Nobel laureate Douglass North (1990) is that 'bad' organisations are allowed to survive, *and may even be encouraged to flourish*, because that is in the interest of elites. Institutions may well claim to have a laudable public benefit purpose – say, 'helping the poor' or 'promoting financial inclusion'— but the deeper reason for their continued existence is because of the distributional advantages that accrue to key individuals and groups linked to these institutions. Going further, leading financial sector analyst William Black (2005) has shown that the era of deregulation that began in the 1970s is defined by the ease and extent to which CEOs, senior managers and key shareholders are now able and willing to quietly subvert the purpose of a financial organisation in order to maximize their own personal and institutional financial enrichment objectives. The losses to the financial institution itself, and to the economy in general arising from this widespread form of what Black calls 'control fraud', are very significant indeed.

These deeply damaging trajectories are raised because they not just accurately describe the structure, conduct and performance of the global microcredit industry today (Bateman, Blankenburg and Kozul-Wright, 2019; Butcher and Galbraith, 2019), but are *especially* accurate depictions of the almost unique situation that has transpired in Cambodia's extensively deregulated microcredit sector. Driving forward the promotion of Cambodia's microcredit sector are the leading MCIs. This includes the two former MCIs that converted

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into commercial banks, ACLEDA and Sathapana, and the largest MCIs that are now deposit-taking and almost entirely owned by foreign financial institutions. This group also promotes its agenda through the powerful Cambodian Microfinance Association (CMA), which is led by the senior managers of the major MCIs. This stakeholder group is ably supported by the most important shareholders and investors working with Cambodia's MCIs, including those self-described as 'social impact investors' and the National Bank of Cambodia, which is itself heavily influenced by the major international financial institutions that promote microcredit, such as the World Bank and its IFC arm. All the experience over the last decade shows that any potential threats that might shift the balance of power in Cambodia's microcredit sector towards clients, and so ensure greater fairness, accountability and transparency in the microcredit sector, will be very determinedly resisted by this elite stakeholder group.

UNWINDING THE PROBLEM

Given the many serious problems outlined above, it is perhaps not surprising that Cambodian academics (Seng, 2017), civil society organisations (Khun, Soeung, Sar and Pilorge, 2020) and many others in Cambodia are increasingly critical of the adverse impact on Cambodia's poor of the country's bloated microcredit sector. Especially in light of the significant bailouts proposed to support failing MCIs in the Covid-19 pandemic crisis, a reconsideration of the role and support provided to Cambodia's microcredit industry is thus urgently needed. Bailing out a major financial intervention that the bulk of the evidence shows has actually failed in its assigned mission to improve the lives of Cambodia's poor would surely be the textbook definition of 'throwing good money after bad'.

So how could the bailout proposals designed to save the global microcredit industry, including in Cambodia, most significantly impact upon the lives and communities of the poor? One way would be to use the emerging bailout programmes to convert inefficient and failing MCIs into a range of far more developmentally effective and genuinely pro-poor community-owned and controlled financial institutions. Contrary to the experience of the microcredit model, local financial institutions such as saver-owned credit unions, member-owned financial cooperatives and democratically-owned-and-managed community development banks have a far better track record of promoting sustainable and equitable local economic development and local poverty reduction (see Goglio and Alexopoulos, 2012; ILO, 2013; Bateman, 2019b). This desired transformation could be achieved by insisting that any financial bail-out is conditional on all or part of the existing equity held by the current owners and investors being swapped for an agreed amount of debt, which is repaid once the new community-owned financial institution is up and running in the post-COVID-19 period (see also Guinan, Leibowitz, McInroy, and McKinley, 2020). Crucially, quite unlike the majority of Cambodia's MCIs, the goal of such local financial institutions will *not* be to grow at a breakneck pace to enrich senior management and shareholders, but to develop at a pace that best serves the needs of existing savers/member/citizens and their communities. Putting finance back in the control of local people would thus be a good thing for Cambodia (see Bateman, 2020b).

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1 As the pioneering experience of the hugely profitable M-Pesa money transfer platform in Kenya has revealed (Bateman, 2020a), an easier and quicker way for global elites to extract enormous value from the poorest communities in the Global South would be very hard to imagine.

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