Microfinance has been a nightmare for the global south. Sri Lanka shows that there is an alternative

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Women's groups and the co-operative movement are leading the way out of the debt trap.

> The global hegemony of finance capital is based on burgeoning household debt accompanied by devastating dispossession. This is more evident in peripheral societies, where state investment in the rural economy is abandoned for the myth of expanding incomes through self-employment with the help of microfinance.

In Sri Lanka, as in many other developing countries, the pawning of gold jewellery, lease-hire purchasing and microfinance lending under the guise of creating livelihoods have mushroomed. Such financialisation of their economies greatly indebts vulnerable rural communities.

Women seeking avenues of credit, as reconstruction failed in the war-torn regions of northern and eastern Sri Lanka due to the Government's flawed policies of mega infrastructure development coupled with credit expansion, were preyed upon by ruthless microfinance companies. Caught in a debt trap, the lingering war-time trauma was intensified by the fear and abuse of debt collectors, with a worrying increase in suicides. However, women's struggles and resistance also mounted which called for a ban on microfinance companies.

Cooperative movement protests against microfinance companies, Jaffna 2018
Photo : Niyanthini Kadirgamar

In this context, building on the vibrant history of the co-operative movement in northern Sri Lanka, a rapidly expanding alternative over the last two years for rural credit is providing some relief and hope.

Predatory microfinance

Starting in the late 1990s, NGOs in Sri Lanka sought to address women's credit and livelihoods needs with microfinance – a model of lending without collateral by holding groups of women responsible for each other's loans.

With the expansion of the financial sector after the civil war, recognising the large profits to be made, numerous companies entered the microfinance business. Among them were around fifty established finance companies, including subsidiaries of major banks, registered with the Central Bank, as well as hundreds of new unregulated companies. Using public institutions, religious places and women's homes as centres for debt collection, loans were provided in return for weekly and even daily installment repayments, with effective annual interest rates ranging from 40% to 220%. The proliferation of these loans created a debt trap, where new loans were taken or money was borrowed from informal sources to pay back previous loans.

As the indebtedness crisis mounted, women's groups in the North and the East of Sri Lanka took the lead in exposing the abusive practices of debt collectors, the fear and humiliation pushing women into hiding and the plight of families torn apart. As national attention focused on the struggles of these women, the culture of blaming the victims propagated by the finance companies, NGOs and many economists – claiming luxurious consumption and financial illiteracy as the cause for the crisis – began to crumble. The exorbitant interest rates, the mounting and unsustainable levels of rural debt and the cases of abuse submitted to officials, delegitimised the microfinance model and wrecked the social standing of the exploitative finance companies.

Addressing indebtedness

Research and campaigns on the indebtedness crisis by women's groups and activists captured the Central Bank's attention in 2017. High-up government officials and the central bank governor consulted women's groups, local officials and the co-operatives during fact finding missions. Large protests by the co-operative movement and women's groups, coupled with the president and finance minister forcefully advocating against the rural onslaught of predatory microfinance, brought forth the need for an urgent solution.

The co-operative movement suggested four steps to address the crisis: decreasing the debt stock through a moratorium on loan payments or debt write off; an interest rate cap to end the exponential increase in debt; alternative avenues for affordable rural credit including through the co-operatives; and policies to increase income streams through collective production as opposed to self-employment.

In response, a one-time partial write off of loans in twelve drought-affected districts and a national interest rate cap on microfinance of 35% were announced. The interest rate cap - significant for flushing out unscrupulous companies - was instituted in December 2018 after a year of lobbying, and amid objections from the economic establishment that it would be interference in the market. A robust Credit Regulatory Authority to monitor money lending and microfinance is likely to be approved by parliament soon.

In the North, credit co-operatives combined their funds with government budget allocations in 2018 and 2019 totaling Rs. 750 million (about €4 million), for a broad credit scheme reaching distressed households to keep them away from predatory lenders. A further allocation of Rs. 1,750 million (€9 million) during the same period is building one hundred small co-operative industries throughout the war-torn Northern Province with the aim of increasing rural employment and livelihoods.

These measures are starting to show some results with fewer complaints of abusive lending practices and rural women avoiding microfinance companies due to greater social awareness. The new co-operative credit scheme during its first year has reached 10% of households in the Northern Province and is likely to reach 25% to 30% of households over the next year if the government's promised funds are disbursed.

The state and challenges ahead

Our research in a coastal village called Karadikundu in early 2017 found a crippling situation of women sinking in fear of multiple debt collectors, and some even mortgaging their homes built with a post-war housing grant to local money lenders in order to pay off microfinance loans. Two and a half years later, they have stopped taking new loans and defiantly refuse to pay back past loans. However, only a handful have been able to access the co-operative loans and their economic situation continues to be difficult. The challenge before the co-operative movement and the state is whether such excluded villages can be set on the path of sustainable development, including affordable access to credit.

The crisis of indebtedness is a consequence of historical cuts in welfare, policies of financialisation that accompanied neoliberal globalisation and the state transferring its responsibility for its rural citizenry to NGOs and finance companies claiming to expand self-employment. Change in the state's vision about finance and the rural economy and a concerted move to mobilise social institutions and democratic participation of the people are necessary for the success and sustainability of the co-operative alternative being experimented with today.

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