Rethinking Collective Action:  
The Case of Microfinance in Brazil and Mexico

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Microfinance—the provision of small loans to low-income individuals—has gained substantial attention from both domestic and international actors because of its perceived capacity to alleviate poverty and inequality. Though the basic premise of microfinance is widely accepted, there is no consensus on microfinance regulation, which has important implications for not only who has access to microfinance services but also for the sustainability of microfinance institutions. In previous research, I show that a focus on power and political contestation around microfinance points to the importance of domestic interests and organized groups in explaining microfinance regulatory outcomes. This study builds on that work and provides important steps in furthering our understanding about the variation in microfinance regulation. In particular, it asks: Why do domestic actors organize to shape regulation in some countries but not in others? Once organized, what determines their effectiveness? Contributing to the collective action literature, this study asserts that the formation of microfinance associations is a function of actors’ ability to access the state and is not determined by its size or homogeneity, as traditional explanations would suggest. Parsing out collective action from what I termed “collective influence,” this research demonstrates that, contingent upon organizing, microfinance associations’ strength emerges from the innovative tactics they employ.
Microfinance, or loans to low-income individuals that aim to reduce poverty and spur development, has spread throughout the world. The Grameen Bank, for example, is world famous for its provision of microfinance and high rates of return. Muhammad Yunus, the “father of microfinance” and founder of the Grameen Bank, began by loaning US$27 to a group of 42 women in a rural Bangladeshi village in 1976. Since the Grameen Bank’s inception in 1983, it has issued US$9.54 billion to 8.29 million borrowers. Just as the Grameen Bank has grown, so too has the international community’s interest in promoting microfinance because of this lending method’s perceived capacity to alleviate poverty and inequality. A recent survey found that leading microfinance donors and investors committed US$14.8 billion to microfinance, of which $3.9 billion—nearly a quarter—were new commitments in 2008. This follows on the heels of widespread recognition of microfinance by international organizations. The World Bank launched an initiative to promote development through microfinance in 2004. The United Nations considers microfinance crucial to achieving the Millennium Development Goal of poverty eradication and declared 2005 the Year of Microcredit. The Nobel Peace Prize Committee awarded Yunus the prestigious prize in 2006 for his work with the Grameen Bank.

Though many are familiar with the success of Yunus’ Grameen Bank, the important role Bangladeshi financial regulation played in this story—and microfinance in general—is less analyzed and understood. In addition to favorable loans from state banks and state subsidies, the Grameen Bank is free to charge market interest rates and mobilize savings. It enjoys deposit-taking privileges and does not have to comply with interest rates limitations due to the Grameen Bank Ordinance, a regulation passed in 1983 that allowed the institution to transform from a non-governmental organization (NGO) into a specialized bank. This ordinance—passed specifically for the Grameen Bank—does not allow other microfinance NGOs to make a similar transformation. As such, all other microfinance providers in Bangladesh are only allowed to accept deposits from their

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1 Others report more historic origins of the microfinance movement (Banerjee, Besley, and Guinnane 1994).
2 Recently, Yunus has been involved in some controversy as the Bangladeshi Central Bank ordered him to step down as the Managing Director of the Grameen Bank noting that Yunus has passed the age of mandatory retirement (Kazmin 2011). Some speculate this move is largely political, given Yunus’ recent derogatory comments about politicians in Bangladesh (Kristof 2011). As of May 5, 2011, the appellate division of the Bangladesh Supreme Court agreed that the Central Bank was justified in removing Yunus from his post (Kazmin 2011).
4 Committed funds include the total amount of all currently active investments and projects, whether the funds have been disbursed or are yet to be disbursed during the remaining lifetime of a project. The top five funders—KfW, AsDB, World Bank, EBRD, and the IFC—account for 46 percent of the total funding committed (CGAP 2009).
5 See Morduch (1999) for an extensive discussion of the Grameen Bank’s use of state subsidies.
members and, more recently, must comply with interest rate ceilings. These regulations severely limit the incentives of other private actors to provide microfinance loans in Bangladesh. Uncovering this aspect of Grameen’s success—specifically deposit-taking privileges and market-based interest rates—highlights the important role of microfinance regulation in influencing both the actors in, and the shape of, microfinance lending.

As illustrated by the Grameen example, regulation can influence the shape of the microfinance market in a number of ways. Recent research has illustrated that the overall performance of microfinance institutions, both in terms of profitability and their ability to provide services to poor segments of the population, varies by the type of institution offering such services including, for example, NGOs, cooperatives, or a deposit-taking institution (Tchakoute-Tchuigoua 2010; Cull, et al. 2011). In addition, complying with interest rate ceilings can also influence who has access to microfinance (Christen and Rosenberg 2000; Helms and Reille 2004). Regulation determines where microfinance institutions can obtain capital and how much they can charge for that capital. In turn, these factors influence who has access to credit (and savings). Regulation ultimately influences who has access to microfinance to improve their prospects to make use of this potentially powerful development tool.

Though regulation is very important to the development of a microfinance sector, it varies substantially across countries. Extant quantitative research illustrates that the variation in microfinance regulation does not follow traditional explanations that emphasize the state and international actors. In previous research, I show that a focus on power and political contestation around microfinance points to the importance of domestic interests and organized groups (Olsen 2011). This study builds on that work and centers on associations of microfinance providers—which are independent and formal domestic networks of a subset of representatives of microfinance providers within a given country. The crucial role of microfinance associations raises the research question and subject of this paper: Why do microfinance associations organize to shape regulation in one country and not another when contextual factors (e.g., socio-economic factors, state strength, and a developed formal financial sector) appear to be similar?

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6 The Microcredit Regulatory Authority (established in 2007) issued an interim ruling capping interest rates for NGO-MFIs under its purview to a flat 15 or 30 percent on a declining balance basis (Economist Intelligence Unit 2009 35).

7 Given the recent controversy around and criticism of microfinance interest rates, numerous scholarly and policy pieces have been written to discourage the implementation of politically-based interest rate ceilings (Meagher, et al. 2006; Fernando 2006; Campion, et al. 2010). Even those concerned that some microfinance institutions may be straying from their original socially-oriented mission are not outright advocates of interest rate ceilings (see discussion in Chapter 2).

8 Since institutional types vary across countries in name and definition, I use “microfinance providers” when describing both unregulated and regulated institutions that provide financial services, in general, to low-income individuals. They may include microfinance institutions, community finance funds (cajas populares), NGOs, credit unions, and cooperatives, among others.
Breaking from traditional collective action arguments, I illustrate that access to the state lowers incentives for leaders from the microfinance sector to organize. Alternatively, when microfinance actors are unable to access the state, well-organized associations form. Not all associations, however, are created equal. Pushing the boundaries of the collective action literature, I argue that once organized, microfinance associations need to adopt innovative strategies and, in doing so, can make even strong states act in particular ways. Collective action, in other words, does not equal what I term as “collective influence.” Understanding the answer to these question posed above allows us to see why associations form, and once formed, how they can shape regulatory outcomes leading to accessible and reliable microfinance services.

A fascinating tale of two states—Brazil and Mexico—illustrates the importance of organized groups and is explored here in depth to address the question above. Initial microfinance efforts began in Brazil just one year after the renowned Grameen Bank got its start in Bangladesh. The Brazilian government was highly supportive of this initiative and a small group of homogeneous microfinance providers emerged. One would expect them to overcome their collective action problems (e.g., in a small group, each member’s personal gain from having the collective good exceeds the cost of obtaining it) and influence policy outcomes. Instead, access to the state lowered incentives to organize; once microfinance associations formed, they were ineffective in obtaining their preferences and only achieved minor concessions through individualistic ties.

Meanwhile, a small, community finance sector grew in Mexico under the auspices of the Catholic Church. Leaders of microfinance institutions coordinated to form a well-organized sector, despite the Mexican state’s initial indifference toward the nascent microfinance providers. When the state finally directed its attention toward the sector, it did so in threatening ways. During this time, a relatively large set of heterogeneous actors consolidated into various organized groups outside of the state’s purview. Only in the late 1990s did the government become receptive to organized groups, which were able to substantially influence regulatory outcomes.

The variation between Brazil and Mexico suggests the important role of organized, domestic actors in shaping microfinance regulation. Why were domestic actors able to form well-organized associations in Mexico and not in Brazil? And in turn, how were microfinance associations able to influence regulatory outcomes?

This study’s focus on microfinance associations helps to fill a gap in our understanding of the processes and mechanisms that explain variation in microfinance

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9 The basis of Olson’s argument is the observation that small groups and large groups attract their members for different reasons (1965, 20–22). In particular, “[s]mall groups can provide themselves with collective goods without relying on coercion or any positive inducements apart from the collective good itself” (Ibid., 34). His argument continues that in large groups, no one individual wants to pay the cost of providing the collective good, given the benefits (which are distributed across members of the large group) are unlikely to exceed the cost (Ibid., 35).
regulatory outcomes. I draw on data collected during fieldwork and employ a comparative historical analysis to illustrate that the current literature on organized interests does not adequately explain the case of microfinance. Instead, I argue that state action can thwart the organization of domestic actors. Brazilian state initiatives in the microfinance sector hindered the organization of these actors, despite the existence of a small, homogeneous group of microfinance providers. Alternatively, patterns of state action and inaction facilitated the consolidation of microfinance associations in Mexico. As a result, Brazil adopted a “state-supported” regulatory framework, which prohibits microfinance providers’ from collecting deposits from the public and places a ceiling on interest rates charged for microfinance loans. This framework and the state’s heavy involvement in the sector stifle the entry of private microfinance providers. Mexico, alternatively, adopted a “financial-systems” regulatory framework in line with international best practices, which allows deposit-taking privileges for microfinance providers and does not require that they comply with interest rate ceilings.

This research also makes important theoretical contributions, as it builds upon the collective action literature by uncovering a new pattern of state-domestic actor relations that facilitates the organization of microfinance associations. In addition, I make an important analytical distinction and contend that collective action (i.e., the ability of a group to organize) must be assessed separately from what I term “collective influence” (i.e., the ability of an organized group to obtain what it wants from the state). In doing so, I highlight the factors that facilitate a group’s organization and second, the tactics and strategies utilized to obtain its desired outcomes.

The following section demarcates the theoretical framework and identifies some of the gaps in the collective action literature. Next, I briefly outline the data collection methodology for this study. The third section delves into the Brazilian and Mexican cases and explores how the formation of microfinance associations helps explain the variation in regulatory outcomes. These cases also illustrate how the formation of microfinance associations defies traditional collective action explanations and distinguish between the formation of microfinance associations and their influence. The fourth section provides a discussion of the theoretical contribution of this study and ends with considerations for future research.

EXISTING ARGUMENTS
What determines when actors organize to influence policy outcomes? The literature focuses on two factors: group size and its heterogeneity (or lack thereof). Olson’s (1965) canonical work theorized that only groups that overcome their collective action problem—generally, those that are small and homogeneous—will achieve the regulatory outcomes they prefer. In large groups, alternatively, only those that can offer selective
incentives to group members are able to overcome their collective action problem. Like Olson, others emphasize the role of heterogeneity as an impediment to a group’s ability to organize in a variety of contexts. Working specifically on groups that are able to self-govern, Ostrom (1995) writes about heterogeneity as a combination of group members’ capabilities, interests, and information or beliefs. Martin (1994) also notes that even in the international sphere, heterogeneity may increase the possibility of conflicts of interests, which can reduce gains from cooperation; not only the number of group members, but the characteristics of those members may serve as an obstacle to a group’s ability to organize.

Yet, there is another, related question to which the literature does not provide a complete answer: why are small, homogeneous groups unable to organize? Olson states that there are no incentives to organize when individual action can achieve the individual’s goals as well as or better than a group that has organized. Specifically, he writes, “there would, for example, be no point in forming an organization simply to play solitaire” (1971 [1965], 7). The most effective groups, he suggests, would be those comprised of a small set of actors with relatively homogeneous interests. Small groups do not need selective incentives or coercion because the benefits of obtaining the collective good will exceed the costs. Moreover, small groups are likely to organize, relative to larger groups, because they face lower costs of monitoring and can more easily control free-riding. Such an explanation is not, however, adequate in clarifying the differences in the two country cases presented in this project. Why were non-state actors in Brazil unable to organize, despite their smaller size and homogenous nature in comparison with those actors in Mexico?

The reason for this shortcoming lays in Olson’s treatment of the state, which is noticeably inactive or “passive and faceless” (Schneider 2004, 22). Building upon Olson’s earlier intuitions, another set of scholarship emerged that includes a leading role for the state. More specifically, these scholars highlight state incentives in facilitating a group’s organization. Bates’ (1981) research on agricultural markets in Africa is innovative not only because he (tacitly) applies the collective-action framework to the developing world, but also because he endogenizes the formation of interest groups with

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10 To be clear, Olson’s argument about the inability of large groups to organize to further their own interests are as follows: “First, the larger the group, the smaller the fraction of the total group benefit any person acting in the group interest receives, and the less adequate the reward for any group-oriented action . . . Second, since the larger the group the smaller the share of the total benefit going to any individual . . .the less likelihood that any small subset of the group, much less any single individual, will gain enough from getting the collective good to bear the burden of providing even a small amount of it . . .Third, the larger the number of members in the group, the greater the organization costs, and thus the higher the hurdle that must be jumped before any of the collective good at all can be obtained” (Ibid., 48).

11 Olson states that his work is meant to explain only those organizations “expected to further the interests of their members,” where interests are economic (1971 [1965], 6, emphasis original). Though, he also suggests that the logic should also apply to philanthropic organizations (Ibid., 6 fn 7).
state policy. Rather than explicitly relying on a collective action explanation, however, Bates suggests that the interventionist policies of the state are the key explanatory factor because they compromise the producer’s efforts to respond rationally to the markets upon which they are dependent. Along this vein, Frye’s (2000) research includes an explicit treatment of Olson and related work that focuses on state-supervised self-governing groups that are isolated or have little contact with the state. The clear contribution Frye makes is in arguing that “[e]xisting theories are not wrong; they simply apply under the restrictive condition that state agents do not influence incentives to cooperate” (Ibid., 33). This observation is also in line with research on Latin American business associations by Schneider (2004), who argues that incentives offered by the state help explain the organization—and dispersion—of business associations in the region.

Though this discussion is far from exhaustive, the research reviewed here represents an important theoretical step—the state helps explain the organization or lack thereof of domestic interests. While pluralists assumed access or participation by all interested parties, others pointed out that the commonality of interests is not a sufficient condition for the formation of active and legitimate groups. Scholars began to argue that government actors had much more power than the pluralist approach allowed (Bauer, Pool and Dexter 1972). This critique “was of great importance because of the explicit recognition that policy formation is affected both by those who seek a certain outcome, as the pluralists claimed, and by those legislators who have discretion over who received the benefits” (Denzau and Munger 1986).

Missing from this discussion, however, is the recognition that while the state can affect interest groups so too can interest groups affect the state. The two organizations co-evolve in that they change in reaction to one another. The relationship is not linear in nature, but dynamic and changing over time.

Once groups are organized, another set of literature suggests interest groups will influence policymakers in predictable ways. Economic approaches to organized interests assume that politicians are rational and self-interested and, as such, will work to maximize their economic utility or reelection. In broader terms, politicians rely on the

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12 Typically, Bates’ (1981) work is noted because he identifies African state leaders’ practice of pursuing economic irrationalities to secure political objectives and thus offers a partial explanation for Africa’s lack of development. Rather than emphasizing international political and economic forces, Bates highlights domestic-level factors that are of equal, if not greater, import.
13 See Ostrom 1990; Milgrom, North, and Weingast 1990; Greif 1993.
14 Empirical examples of collective interest and regulatory capture have been well-documented in the literature on the formal financial sector. Haber (2004), for example, carefully documents that during most of the nineteenth century states in the United States were unable to extract revenue via taxes on interstate trade or issue currency and, as a result, they relied on their right to charter banks to fund state activities. Kroszner and Strahan (1999, 2001) illustrate how branching deregulation in the United States reflected industry developments and the power of particular interest groups. This line of literature, in general, suggests that since regulatory benefits are generally widely dispersed, policy is influenced by the power of organized interest groups.
stability of the financial system to not only finance many state-led activities, but also to ensure economic growth and prosperity. Both of these economic goals are important to their own political survival and the longevity of the regime (Przeworski and Limongi 1993). The “private-interest approach” theorized that private actors could organize to achieve their own goals, distinct from social welfare, by capturing state actors. Stigler (1971) drew on Buchanan and Tullock’s (1962) classic work on political utility maximization and Downs’ (1957) insight into why voters might stay uninformed (“rationally ignorant”) about public policies due to their weak incentives to seek information. Stigler wrote, “as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit” (1971, 3). Stilger’s is a story of interest groups’ complete capture of state regulators.¹⁵

Peltzman (1976) provided extensions of Stigler’s theory by emphasizing how legislators are motivated by reelection. His work suggests that interest groups only partially capture politicians. In both models, however, the government is a broker for redistribution among interest groups. Thus, an organized groups’ effectiveness is largely based on their ability to “capture” state actors (Stigler 1971; Peltzman 1976) or to provide campaign contributions (Austen-Smith 1987; Baron 1994; Grossman and Helpman 1996). At the foundation of these models, however, is the interest groups’ ability to either deliver financial support or votes to maximize the politicians’ utility, through financial inducements, reelection, or both.

The contribution of this research is twofold in that it more accurately explains first, why associations form and second, why they are effective. To the first point, I find that the case of microfinance organization highlights the importance of state action and inaction in determining influence. Paradoxically, access to the state can stymie collective action on the part of microfinance organizations. State action, when threatening, however, can motivate actors to organize. State inaction, or periods in which individuals have autonomy to organize outside the purview of the state, may also foment such organization. In this way, this research departs from previous understandings of the role of the state in organizing non-state domestic actors. As outlined above, the case of Brazil indicates that regular interaction with the state can thwart the organization of non-state actors, even when they are a relatively small group of homogenous actors. Alternatively, periods of state inaction—as was the case in Mexico—can facilitate non-state domestic actors’ coordination and consolidation.

The second contribution of this work is that it differentiates between collective action and collective influence. Olson assumes that small groups only organize to influence the state or that the two processes are one and the same. This analytical step is

¹⁵ The “public choice” literature grew out of these developments in economics. This work argued that politicians and bureaucrats did not pursue the public interest, but instead were participants seeking to pursue their own interest.
missing, however, in Olson’s treatment of large groups. He argues that large groups, unlike small groups, form initially for some other reason for which selective incentives are offered or coercion is at play; aiming to influence policy outcomes is simply a by-product of this initial incentive to organize. Selective incentives facilitate large groups’ organization, but it is less clear when large groups decide to lobby for a particular policy outcome and how they are effective in doing so.

Though the interest group literature highlights the wide variation in interest groups’ strategies, scholars focus primarily on a group’s ability to capture politicians or meaningfully influence them by contributing to their reelection (via information dissemination, voter turnout, campaign contributions, etc.). In the case of microfinance, however, microfinance associations do not rely upon either of these mechanisms. Their financial resources are generally quite modest, especially in comparison with other domestic or international financial lobbies. Moreover, microfinance associations’ efforts to influence regulation do not appear to coincide with the electoral calendar.

The tactics and desired outcomes of organized microfinance groups differ from those identified in the current interest group literature. Microfinance associations’ desired outcome, then, is regulation that will allow the sector to grow (via accepting deposits from the public and charging market interest rates) with appropriate standards to avoid cases of fraud—regulation that exacts substantial cost on the microfinance providers these associations represent. Conditional upon organizing, their ability to exert influence is a function of their size and heterogeneity, as they represent microfinance providers which are quite diverse in terms of which individuals they serve and their broader ideology about microfinance, in general. Effective tactics help microfinance associations keep their distance from high-level political actors, though they engage with mid-level bureaucrats. Moreover, given the informal nature of the microfinance sector, states know very little about the actors that create the microfinance market. Microfinance associations, then, provide a wealth of information about the microfinance sector—both in form and function—that would otherwise be unavailable to state actors. In providing information about the sector, these groups first convince state actors that the sector can be monitored and regulated. They then adopt a primary role in helping the state design legislation that would allow it to do so. The cases explored below illustrates that microfinance providers organize and engage with the state in unexpected ways.

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16 See fn 12.
17 Certainly this particular outcome is not the only one—there are other issues that microfinance providers might agree upon, including taxation, access to cheap capital, and the like. In addition, there are other pieces of regulation that actors may not agree upon, including the role of for-profit entities or commercial banks engaging in microfinance. Regardless, accepting deposits and charging market interest rates, are widely understood to be instrumental for the long-term sustainability of microfinance institutions.
CASE SELECTION & DATA COLLECTION

This paper focuses on two specific cases for both research design and theoretical reasons. In selecting cases for this study, I chose two countries—Brazil and Mexico—that illustrate variation on the key explanatory variable as is considered best practice (King, et al. 1994). Moreover, these cases allow me to control for other potentially relevant causal variables as they share a common economic and political trajectory, relative to other cases. Economically, both countries began the century as primary product exporters rich with natural resources, and implemented horizontal import substitution industrialization (ISI) during the Great Depression and vertical ISI thereafter. Since the 1970s, both countries have worked to expand local production of capital goods and diversify their exports. In addition, both countries faced substantial disruption from the 1982 debt crisis and the “Tequila effect” of the mid-1990s. Today, leaders are improving their research and development sectors, working to attract foreign direct investment and continue to maintain close relationships with IFIs. Both countries have several political similarities, as well; they are federalist systems and endured a variety of authoritarian rule (military rule in Brazil; single-party rule in Mexico). Clientelism taints party politics in each country, despite the fact that Mexican political parties are more disciplined and less fragmented than their Brazilian counterparts.

The analysis presented here draws from in-depth field research conducted in Brazil and Mexico in 2008-2009, where I completed over 100 interviews with various actors (microfinance lenders, borrowers, politicians, bureaucrats, and international organizations), gathered government documents, and traced journalistic accounts of the development of the microfinance sector. This material is used to explore the development and transformation of microfinance in Brazil and Mexico.

MICROFINANCE IN MEXICO & BRAZIL

The Case of Mexico

The state and the microfinance sector co-evolved in a process whereby the state and microfinance sector changed in reaction to one another. In the first phase, I discuss an era of community finance followed by a period in which the state played a prominent role in creating its own “community finance” institutions and regulating the traditional community finance sector. The microfinance sector perceived the state, in large part, as a threat to their work. This phase ends with an era of organization, as microfinance institutions consolidated into eight different microfinance associations. Process-tracing

18 With the support of Fulbright-Hays, I conducted fieldwork over the course of a year, during which I spent six months in Brazil and six months in Mexico. Appendix A includes a descriptive table of the number of individuals interviewed from each sector, by country. To maintain anonymity of the interviewees, the codes used to cite interviews throughout this paper are described in this appendix, as well.

19 “Community finance” is used in this section only to denote that these efforts predate contemporary microfinance as we know it.
analysis reveals that microfinance associations evolved during periods of state action and inaction. The state’s action provided motivation for the sector to work together, as the state was largely perceived as threatening to the sector. State inaction gave the microfinance institutions time to grow and consolidate into microfinance associations. The second phase illustrates that in the case of Mexico, strong forces have acted on the state—either in contestation or collaboration—to shape state policies around microfinance.

**State Inaction and State Threats; Strong Microfinance Associations Form**

Mexican microfinance had humble beginnings, with the absence of state and international actors’ support of early efforts to promote lending to the country’s poor. Early experiments in microfinance, *cajas populares* or “community finance” in Mexico began under the guidance of the Catholic Church in the 1950s. Community funds, in general, were small, informal institutions that aimed to offer financial services to the poor and, in particular, the rural poor. Mirroring their Canadian counterparts, each community fund belonged to a regional federation, to which member institutions paid dues for technical capacity training and supervision. The federations provided a self-regulatory structure, aimed at monitoring the stability and strengthening the quality of the sector. Between the early 1950s and the mid-1960s, community funds continued to grow, though informally, outside of the purview of the state.

The expansion of the community funds did not go unnoticed by the state for long, as these funds and their federations came to represent the increased local power of the Church, which the state viewed as politically threatening. This was, after all, the first time that the provision of credit was reaching low-income populations and not formally affiliated with the state (Soto and González-Vega 2006, 27). In the early 1960s, authorities suggested these institutions were operating illegally and referenced the Cooperative Law of 1932 (Ley de Cooperativa), which did not support financial cooperatives, only producer and consumer cooperatives. These threats subsided when a community finance leader (Father Velázquez) enlisted the support of the Credit Union National Association (CUNA), a well-known international organization that encourages the provision of financial services around the world.

In response, six federations formed together to create Mexico’s first microfinance association: the Mexican Confederation of Community Funds (CMCP, Confederación Mexicana de Cajas Populares) in 1964. This organization was formed, in large part, because of a broad concern about the security of the sector given the all but certain return of the state (Romero 2006). The goal was to ensure the financial stability of the sector and unite it, as institutions unaffiliated with the Church were also beginning to emerge. The CMCP assumed responsibility for supervision and control of all community funds.

Throughout the 1970s, the state continued to look the other way while the momentum of the CMCP prompted the community funds to strengthen and
professionalize their administrative capacity.\textsuperscript{20} During this time “several community funds went from relying on volunteers to a process of professional recruitment for its management, which in short time resulted in an accelerated growth” (Soto and González-Vega 2006, 27). By the early 1970s, there were hundreds of community funds, serving nearly 30,000 members. Over the next twenty years, the number of clients grew almost 2000 percent, even though it continued to be a movement at the fringes of the law (O’Keefe 2007).

The state once again turned its attention to this sector in the 1980s and 1990s—this time, it sought to provide credit directly to Mexico’s low-income population and, as outlined below, to regulate the sector. During his administration, President Salinas created 362 new credit unions, more than doubling the number established during the previous 35-year period (Muñoz, Santoyo and Altamirano 2002). Unsupervised lending resulted in other forms of patronage for formal businesses to obtain finance. One employee openly confirmed that such institutions “are often considered a window through which you can ask for something that comes from above” (Gentil and Doligez 1994, 50). Unlike the credit unions elsewhere, Mexican credit unions were not able to accept deposits from the public or their members and, instead, relied entirely on funding from the state. Such dependence meant that they were subject to the state’s political agenda, as well. “The ban on accepting deposits from the public established in the beginning . . . resulted in institutions’ access to easy money; it meant that the majority of the funding for unions came from first- and second-tier lenders [of the state]” (Soto and González-Vega 2006, 18).\textsuperscript{21}

In addition to being an era of increased provision of state finance, the 1990s was also a period of regulation. While Salinas was ramping up public financing for state-led finance institutions, the state also began to investigate the landscape of the community finance sector. In 1989, the National Banking and Securities Commission (CNBV, Comisión Nacional Bancaria y de Valores) published a study that highlighted the sector’s expansive reach (MFA2).\textsuperscript{22} In the early 1990s, there were 234 community funds with a total of approximately 550,000 members (Carstens 1995, 122). The state was alarmed by the size and depth of the sector and recognized the importance and need for regulating the sector (MFI1).

\textsuperscript{20} Note that Zúniga (2001) seems to suggest that the state was disinterested once the Catholic Church was no longer at the helm of the community finance sector. This claim, however, is not explicit and though I have not been able to confirm it elsewhere, I have not encountered evidence that would suggest the state intervened during this time.

\textsuperscript{21} NAFIN (Nacional Financiera) is a state development bank; BanRural is the National Bank of Rural Credit (Banco Nacional de Crédito Rural, the National Bank of Rural Credit); and the Trust Funds for Rural Development (FIRA, Fideicomisos Instituidos en Relación con la Agricultura) is also a development bank dedicated to rural finance.

\textsuperscript{22} At the time, the CNBV was known as the CNBS, the Comisión Nacional Bancaria y de Seguros. Unfortunately, I have not yet been unable to obtain a copy of this study.
Many from within the sector saw the CNBV’s study as a window of opportunity. This was a moment in which the community finance sector could illustrate their professionalization, increased administrative capacity, and self-regulatory structure, and perhaps influence the state’s regulatory decisions. The CMCP was interested in partnering with the state so that the regulatory framework adopted might fit what they had worked hard to establish. The CMCP, in particular, wanted to ensure that the already-existing federations would regulate community funds and that these organizations could legally accept deposits (MFA2; MFI1). In preparation, the CMCP began researching legislation in other countries and drafted a bill of their own.

Unfortunately for the CMCP, the state wanted to regulate on its terms. “[D]espite the lobbying efforts of the CMCP, the authorities were reluctant to regulate the community fund as a legal entity” (Carstens 1995, 130). Instead, the state instead passed regulation that attempted to formalize the community finance sector by creating new types of financial institutions—the Savings and Loan Society (SAP, Sociedad de Ahorro y Préstamo), which came into effect in 1992.

It was no coincidence that this legislation resulted in a major shift in power. Politically, this legislation was understood as a direct attack on the CMCP, as it was deemed illegal. All community funds, instead, were required to become SAPs and would be regulated by the CNBV. This meant that the self-regulatory structure—the regional federations established in the 1960s—was no longer necessary (Zúñiga and Guerra 2001, 230). Moreover, under this new regulation, SAPs were unable to accept deposits from the public (Ibid.). Politicians and regulatory leaders imposed high minimum capital requirements, which few institutions were able to meet. SAPs incurred costs associated with being supervised by the CNBV (Soto and González-Vega 2006, 33). These and other regulatory asymmetries were created by the legislation. Many from the community finance sector note that the SAP was dysfunctional because those who drafted it knew very little about microfinance in Mexico.

_The Proliferation of Microfinance Associations_

The influx of state-led institutions and the state’s attempt to regulate the sector and all but abolish the CMCP spurred the community finance sector into action. While the CMCP began in the 1960s, additional microfinance associations formed in the early 1990s in response to the state’s entry—both as financiers and regulators—into the sector. The regulation outlined above—by default or by design—created schisms within the community finance sector associated with the CMCP and, as noted earlier, significantly weakened the power of the CMCP. This resulted in one association—Mexican Association of SAPs (AMSAP, Asociación Mexicana de Sociedades de Ahorro y Préstamo). The new SAP law also failed to include the system of “protection funds,” which had been established by the federations. This was an integral part of the community funds sector which, with the passage of the SAP regulation, was now obsolete (MFA2).
Préstamo)—that represented those institutions that had successfully transformed into SAPs. The remaining 61 smaller organizations merged to form the Caja Popular Mexicana (Soto and González-Vega 2006, 30) and continued to be represented by the CMCP.

Another association, formed in 1990, was created with the specific purpose of distinguishing itself—and maintaining distance—from the state. The Mexican Association of Social Sector Credit Unions (AMUCSS, Asociación Mexicana de Uniones de Crédito del Sector Social) represents the non-state rural credit unions, primarily serving rural and indigenous populations (Bouquet and Cruz 2002). These institutions, different from the state credit unions that were ramped up during the Salinas administration, reacted strongly to the state’s launch of the solidarity funds and the “Credit on Your Word” program, the latter of which they characterized as “an outlay of resources directly from the state” (Bouquet and Cruz 2002, 58). Without an alternative voice, the leaders of these institutions were concerned the state could potentially dilute and ultimately devastate the rural financial market.

Another group of community finance leaders gathered to form the Mesa de Empleo (Employment Roundtable) in 1992 to study the obstacles to making credit accessible and promoting savings among low-income populations. The participants at the Mesa de Empleo were comprised of 21 distinct microfinance institutions (O’Keefe 2007). The objective of this event was to create changes in public policy that would enable microfinance institutions to become formally regulated—they wanted to become legal (MFI1; MFA2; MFA4). The informal status of many in the sector prevented them from advertising savings accounts, applying for commercial finance, or accepting grants from some international development agencies.

A key consequence of the Mesa de Empleo is that it provided a forum where these institutions could organize. The National Association of Regional Cooperative Unions (ANURCO, Asociación Nacional de Uniones Regionales de Cooperativas) was created in 1993 to encompass organizations that were previously part of the CMCP. In addition, ProDesarrollo formed in 1997; this association consisted primarily of urban-based NGOs that were not part of the original community funds sector. As of 2000, there were seven well-established microfinance associations (see Table 1).

Why did microfinance institutions organize into associations? What facilitated microfinance associations’ ability to overcome their collective action problem? Olson (1965) tells us that when groups are large, selective incentives are necessary to incentivize actors to organize. This logic has some resonance when applied to the first microfinance association that formed in Mexico—CMCP—but none of the other
organizations provided selective incentives. We would then expect the other organizations to be small and homogeneous, yet this description does not fit either. Most associations are comprised of a variety of institutional types, which also vary in size, the type of clientele served (rural or urban), as well as the ideological perspective held by the directors of the microfinance institutions. What, in sum, facilitated the continual organization of these relatively large, heterogeneous groups of actors?

The history of microfinance in Mexico highlights another pathway to overcoming collective action problems—one that links the sector and the state and emphasizes their co-evolution. The sector’s distance from the state facilitated the evolution of their organization. The state as financier created its own institutions, which the sector perceived as a threat to its own work in community finance. The state as regulator created schisms within the sector and ultimately failed in its attempt to regulate and reign in the community finance sector. The state’s actions toward the microfinance sector were perceived as ineffective at best and aggressive at worst. The microfinance associations united, in part, because they had limited ability to engage with or address the state.

_Microfinance Associations’ Strategy to Influence Policy_

Microfinance associations began working together to determine a strategy to strengthen the sector and address the insufficient regulatory environment. What was unique about this period is that—despite their ideological differences about popular finance—key actors began to work together in hopes of promoting a regulatory framework that could strengthen the sector, not simply fulfill short-term political interests. “[T]his initiative came primarily from associations like AMSAP, ANURCO, and outside the community funds sector, ProDesarrollo. This meant that various legal organizations were coming together, which meant they were also supported by the rest of the associations” (O’Keefe 2007, 7). Even so, the state was not immediately interested in partnering with the sector in any meaningful way. Organizing was not enough; the sector needed a clear strategy to garner the state’s attention.

Throughout the 1990s, the sector worked together and adopted unique tactics to engage with the state. In particular, they employed three key strategies: pulling together a heterogeneous set of actors, reaching out to mid-level bureaucrats, and utilizing a research-based approach to the regulatory question. The microfinance sector used this

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24 The CMCP was charged with training and monitoring its member institutions. In return, these institutions had access to additional financial resources, as CMCP addressed cash-flow issues by redistributing financing from those community funds that had a surplus to those that needed more capital to distribute (Foro 1998).

25 The traditional community fund sector felt that the social mission inherent in popular finance was being trumped by new actors’ interest in making money. Microfinance, in general, does not exclude those organizations with a social mission, but it does not require that they have one either. Some of the more socially-oriented institutions wanted recognition that their model was unique from the profit-oriented organizations.
three-pronged approach to garner the necessary support from within the Mexican state to advance the sector’s preferred policy outcomes.

First, microfinance providers and associations united a diverse set of actors from within the microfinance sector. The Mesa de Empleo was the first event at which the sector—in all of its diversity—was not only represented at the table, but also actively engaged in the discussion. Institutions associated with the community finance movement, non-state credit unions, NGOs, and even profit-oriented microfinance institutions were able to discuss their concerns with one another.\(^{26}\) In addition to a variety of institutional types, the Mesa de Empleo included representatives from rural microfinance providers as well as their urban counterparts. Others have noted that a survey of the sector “reveals the great heterogeneity that characterizes these organizations in Mexico, as a result of historical, cultural, and political processes” (Soto and González-Vega 2006, 48).

Second, microfinance associations specifically avoided involving politicians in early discussions and instead sought to create alliances with mid-level bureaucrats. This was a conscious effort described by a number of interviewees (MFI1; MFA3; MFA2). They did so not only in an effort to teach bureaucrats about the microfinance sector, but also to learn from them. Specifically, representatives of the microfinance associations were interested in understanding what types of regulatory regimes were feasible and prudent, given the existing Mexican financial regulatory structure. Early discussions of microfinance regulation occurred between bureaucrats and microfinance associations, focusing on what was possible, on the one hand, and what was needed by the sector, on the other. Only once these actors—microfinance associations and state bureaucrats—found some common ground were political actors involved (MFI1; MFA3).

Finally, the microfinance sector adopted a research-based perspective to the regulatory question. To reach bureaucrats (the CNBV, the Central Bank, the Ministry of Finance, among others), microfinance associations could not simply dictate what they wanted. This was impossible in part because the sector had not yet agreed upon what it wanted. In addition, there was skepticism on the part of state actors toward the sector. Thus, there was a heavy emphasis placed on research and learning. The microfinance associations took the initiative to not only discuss the future of the sector but also to gather appropriate information on legal frameworks in other countries. Their proactive stance and innovative approach toward changing the regulatory framework ultimately enabled the microfinance sector to play an important role in the design of the law.

Once microfinance associations began working with government officials to generate legislation for the microfinance sector, they were doing so in the midst of broader political change. In 1997, the PRI lost control of Congress and, in 2000, Mexicans elected Vicente Fox of the PAN party—the first non-PRI president in over 70

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\(^{26}\) The SAP regulation was passed in 1992, so no SAPs or CAPs had formed when the Mesa de Empleo was held.
years—who happened to also be a strong proponent of microfinance. In fact, Fox announced his presidential candidacy in front of a microfinance institution in Querétaro (Notimex 1998). He repeatedly spoke of microfinance on the campaign trail and mentioned microfinance in his inaugural address given December 1, 2002. Fox stated: “We must boost microfinance institutions and credit unions, which practically do not exist in Mexico. In all other parts of the world, [they] are fundamental pillars of the financial system” (cited in Grillo 2002).

The microfinance sector appreciated Fox’s interest in promoting microfinance, but was also cautious. The sector was concerned about Fox’s planned use of subsidies and state-financed microfinance institutions—much like those that grew under Salinas. He favored a state-led approach to microfinance and it was clear that Fox envisioned a prominent role for the federal government in promoting microfinance, as he had done with the Guanajuato state government.

The microfinance sector did not look favorably upon this plan. First, the sector was greatly concerned that government-provided loans would muddy the definition of microfinance. More importantly, however, the microfinance sector took some offense to Fox’s plan because they already had a plan of their own. Recall that meetings between the microfinance sector and the CNBV were ongoing throughout the presidential campaign season. By the time Fox was elected, participants—microfinance providers and state bureaucrats—already had created draft legislation.

Multiple actors spoke out against Fox’s state-led version of microfinance—the sector itself, international actors, the Mexican banking sector, and even members of his own administration. Fox’s appointee to the National Program of Microenterprise Finance (PRONAFIM, Programa Nacional de Financiamiento al Microempresario)—an organization he established to support microfinance in Mexico—was an academic and largely unfamiliar with the Mexican microfinance sector. One interviewee recalled a meeting with the board of PRONAFIM and President Fox, at which Fox was pushing for PRONAFIM to provide subsidies to microfinance institutions. There was opposition from the board and after some discussion, a board member reportedly slammed his hands on the table and shouted “we are tired of seeing the government give money away in this country” (S3). This, according to some, was a defining moment for Fox’s change of heart.

Ultimately, Fox’s vision of a state-led microfinance sector was overturned. A state-led approach was a possibility in Mexico. Not only was there a history of a more state-supported approach toward microfinance (through Salinas’ creation and funding of various financial institutions directed toward the poor), but President Fox also expressed a strong interest in expanding his Guanajuato-based state-funded first-tier lending institution at a federal level. Instead, a heterogeneous set of microfinance associations used innovative strategies to influence the state. The passage of the 2001 Law of
Community Savings and Credit (LACP, Ley de Ahorro y Crédito Popular), institutionalized a financial-systems approach toward microfinance and constituted a turning point for the microfinance sector in Mexico. The LACP established a tiered framework that would work with and complement the heterogeneity of the sector and allowed microfinance institutions to accept deposits. The microfinance sector—though its heterogeneity, organization, and innovative tactics—created partnerships throughout the state such that a state-led approach to microfinance was unacceptable by the time Fox assumed the presidency. Microfinance associations, in other words, were able to check state power.

The Case of Brazil

To the surprise of many observers of microfinance, Brazil is home to the earliest microfinance effort in Latin America. In 1972, international organizations worked closely with the state to create the region’s first microfinance organization, Project UNO (União Nordestina de Assistência a Pequenas Organizações) in Northeastern Brazil. Unfortunately, UNO closed its doors in 1997—18 years after its initial start (Barone et al. 2002, 22), partly because it was never self-sustaining. “The financial donations UNO received could not be transformed into financial assets that could be lent at market rates and thus, facilitate [the organization] to charge real rates on all of their lines of credit” (Ibid.). Despite early support from international actors and the state, there was no long-term solution to UNO’s inability to access capital. UNO had to comply with interest rate limits and had no access to independent sources of finance. Instead, the organization served as an intermediary and relied heavily on state and international institutions for financing. The challenges UNO faced are emblematic and representative of the difficulties the sector faced—and continues to face—more broadly. The authors of one report reflected that “[t]he story of microfinance in Brazil has mostly been one of unfulfilled promise” (Meagher, et al 2006, 15).

Unlike the Mexico case, the microfinance sector in Brazil has had access to the state—via policy circles or through access to state funding—which meant that the microfinance sector never sought to organize. Incentives to do so were low, given the sector was invited to participate in discussions about improving the microfinance regulatory framework. The sector tried to organize in 1999, but only after Congress passed legislation that the microfinance sector deemed unsatisfactory. Two associations formed and though they overcame their collective action problem, they were not influential. Rather than adopting the strategies seen in the Mexico case, microfinance leaders relied on individualistic ties with the state to achieve relatively minor concessions. They were unable to check state power and Presidents Cardosso and Lula promoted a state-led version of microfinance—where deposit taking is not allowed and
the microfinance sector relies on state funding with interest rate ceilings. The state also participates directly, offering microfinance services at subsidized rates.

**Access to the State; No Microfinance Associations Form**

Numerous microfinance institutions opened their doors in the mid-1980s—all of which relied heavily on state or federal funding.27 Despite the earnest effort of local, state, and international actors, many of these microfinance initiatives only achieved moderate growth. Scholars conclude, “one of the most oft-cited reasons for this delay is a tradition of government-directed and subsidized credit and an unfriendly regulatory environment” (Barone et al. 2002, 9). Indeed, these challenges still persist today. Rather than observing the expansion of microfinance institutions though state and international partnerships, the sector struggles with the same issues that plagued Project UNO. Microfinance institutions, even today, are unable to accept deposits from the public and, as a result, are heavily reliant upon the state for financing and their existence. Access to the state—policy circles and subsidized funding—lowered incentives for the sector to organize.

Discussions about how the state could support the microfinance sector more strategically began during the Fernando Henrique Cardoso administration (1995-2002). Just one year after Cardoso’s entry into office, in 1996, the BNDES—Brazil’s development bank—launched a program to support microfinance activities, the Productive Community Credit Program (PCPP, Programa de Crédito Produtivo Popular). The federal government allotted US$150 million for the implementation of this program, as BNDES worked to “spread microcredit and promote the formation . . . of institutions capable of providing credit to both formal and informal microentrepreneurs” (Bercovich 2006, 97). According to BNDES, it supplied between 50 and 80 percent of funding for most of the microfinance institutions with which it worked (Kumar 2005, 94). This credit line had a repayment period of up to eight years and interest rates according to the TJLP (Long Term Interest Rates), which were then estimated to be 0.5 percent monthly (Goldmark et al., 2000). Institutions were heavily reliant upon this funding and “[t]he below-market funding of the client microfinance institutions of BNDES, even if justifiable in a start-up phase, lacked an articulated ‘exit’ strategy” (Kumar 2005, 100). Given that lack of commercial finance and the inability of microfinance institutions to collect deposits, the funds received from BNDES represented the primary lifeline for the vast majority of microfinance institutions in Brazil.

However, it was Cardoso’s wife, First Lady Ruth Cardoso, who put microfinance regulation on the national agenda through the “Solidarity Community,” which was intended to be a public-private partnership that would foster an improved state-society dialogue surrounding Brazil’s most pressing social issues. The Solidarity Community

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27 CEAPE (Centro de Apoio aos Pequeños Emprendedores) was launched in Porto Alegre in collaborative effort between local actors, the Brazilian state, and international financial institutions. One well-known effort was the Banco da Mulher, created in 1984 under the auspices of the INGO Women’s World Banking.
served as the primary forum through which the microfinance sector made their interests known. This organization was established to “recognize the strategic role of society in the development process, as an autonomous place of self-generation of public policies, extending the public space, as is necessary to strengthen democracy” (Comunidade Solidária 2002a, 11).

With such a mandate, participants in the Solidarity Community had high expectations for the group. Despite the microfinance sector’s attempt to communicate their preferences, the regulations that were developed from the Solidarity Community differed substantially. The first law developed a new institutional figure, the Civil Society Organizations of Public Interest (OSCIP, Organizações da Sociedade Civil de Interesse Público).\(^{28}\) This regulation was primarily created to address problems within the non-profit sector and only tangentially addressed the microfinance sector. As such, the sector was unsatisfied with the new OSCIP institution. In particular, OSCIPs were non-profit and were prohibited from borrowing money from commercial creditors.\(^{29}\) OSCIPs could not accept deposits from the public and were still required to comply with interest rate ceilings.

Later that year, in August 1999, a subsequent piece of legislation created another institution—specifically for the microfinance sector—the Society of Credit to the Microentrepreneur (SCM, Sociedade de Crédito ao Microempreendedor).\(^{30}\) SCMs are intended to be for-profit institutions that can engage in microlending. According to this regulation, an SCM can be for-profit and is also able to borrow from commercial sources, unlike the OSCIP. In other words, SCMs are part of the broader financial system. As such, the Central Bank of Brazil is responsible for authorizing SCMs, while OSCIPs are only required to register with the Ministry of Justice. In practice, this means that while SCMs can borrow from national and foreign financial institutions, they must also comply with the regulatory requirements of formal financial institutions. Moreover, they are subject to the tax regime for financial institutions. These heavy reporting and tax requirements, however, are not offset by the ability to accept deposits. Indeed, Kumar (2005) points out that these requirements are clear disincentives for NGOs or OSCIPs considering converting into an SCM.

\(^{28}\) The Law of the Non-Profit Sector (Lei do Terceiro Setor) was passed in March 1999. OSCIPs are organizations that provide a range of social activities, including the “promotion of economic and social development and the fight against poverty [and] non-profit experimentation with new models of socio-productive systems and alternatives to production, trade, employment and credit” (Chapter I, Article 3, Law 9.790).

\(^{29}\) OSCIPs also wanted to be exempt from paying the employer’s share of social security (Ferrarezi 2001, 9).

\(^{30}\) This resolution establishes the formation and operation of SCMs, legal entities under private law, with for-profit status, whose sole objective is to grant loans to individuals, to accommodate the development of legal entities classified as professional, commercial, or industrial small and microenterprises (Zouain and Barone 2007, 376).
The microfinance sector, however, remained unsatisfied. They argued that SCMs, given the reporting and regulatory requirements, should be able to accept deposits. With few from the sector interested in utilizing the SCM framework, the Solidarity Community organized a roundtable in 2001 to specifically address the lingering concerns about the potential growth of the microfinance sector, entitled “Expansion of Microcredit in Brazil” (Comunidade Solidária 2002b, 88). The purpose of this group was to “contribute to the induction, development, and implementation—directly or indirectly—of public policy on the access to credit as a means of combating poverty and social exclusion” (Barone and Zouain 2004, 373).

As was customary with the Solidarity Community, a wide range of participants was present. Eight representatives from the international community were present, including individuals from Acción International, the United Nations Development Program, the World Bank, and the IFC. In addition, seven representatives from the microfinance sector were present. The more than 45 representatives of the state, however, dwarfed the international representatives and members of the microfinance sector (Comunidade Solidária 2001).

A subset of representatives gathered to join a Committee on the Legal Framework for microfinance, at which the ability for microfinance institutions to accept deposits was discussed. The Committee held five meetings to discuss how the current framework could be improved. Of the members on this committee, two were from research-oriented institutions, four were international actors, and five were from the microfinance sector. Again, the state dominated the committee with 31 representatives. In an internal memo of the Solidarity Community, it is noted that one of the key proposals of the subcommittee was to “allow microcredit institutions to offer a diverse set of financial services that could be utilized by their clients—beyond microcredit, including the capture of savings” (Comunidade Solidária 2001). Under “Progress,” the memo simply stated: “This proposal will be addressed later, as it would require the alteration of the Law” (Ibid.). Kumar (2005) notes that “most controversial, in terms of measures to aid SCMs, is the question of whether they should be allowed to mobilize deposits and offer savings products” (89).

Though “[t]here existed a very important involvement on the part of the microfinance institutions” during the workshops and roundtables of the Solidarity Community, the sector was not able to obtain its preferred policy preferences, including the ability to accept deposits from the public (MFI2; MFA1; MFA2). While some were optimistic that commercial or state financing would help the sector grow, others recognized the difficulties inherent in these limited funding options. In particular, though SCMs and OSCIPs were no long subject to usury requirements, this regulatory change was largely meaningless in practice since subsidized funding still dominated the sector (I7; MFI2).
By the end of Cardoso’s term, the sector was disappointed with the regulatory framework that was established. Though the microfinance sector recognized that state funding kept them afloat, they were also frustrated by their inability to access deposits. Without deposits, the microfinance sector was competing with institutions that had substantially more funding from the state, like the People’s Banks or, in the Northeast, CrediAmigo. Even with multiple institutions and substantial funding, estimates suggest that at the end of Cardoso’s administration, the penetration of microfinance—the percentage of the demand served—was estimated at only two percent (Christen 2000).

With acknowledgement on behalf of many key actors that the environment for microfinance institutions was subpar, why was the sector unable to push for a more conducive regulatory framework? Despite being a small group of relatively homogeneous actors, leaders of these microfinance institutions had low incentive to organize because they had access to the state—both in terms of political access through the Solidarity Community and, in general, financial access via local or federal funds. Such access lowered the incentives for microfinance actors to organize together because the lines of communication with the state were already open. Interestingly, when the state willingly provides outlets for microfinance lenders to discuss regulation, it thwarts the organization of domestic actors. It seems unlikely this was an explicit strategy of the state, but perhaps an unintended consequence of the co-evolution of the state and the microfinance sector. Without an organized opposition, the state assumed a dominant role in the promotion of microfinance, adopting a state-supported approach in the regulation of microfinance. Lack of organization, however, also meant that the sector was unable to check state power. With little opposition, the state established a regulatory framework that promoted a state-supported approach toward microfinance.

**Formation of Weak Microfinance Associations; Fail to Influence Policy**

Optimism spread across the microfinance sector with the election of the leftist Worker’s Party candidate, Luiz Inácio “Lula” da Silva, in 2003. Lula often spoke of microfinance and access to financial services during his campaign. One interviewee described the pure elation across the sector with Lula’s election: “Oh, how we celebrated. We thought this was going to be the golden era of microfinance!” (I7). Instead, Lula’s administration (2003-2010) advanced an even greater position for the government—increasing its role as a first- and second-tier lender, directly providing credit and other financial services through government banks while also increasing financing to current microfinance institutions. Those working in microfinance reported being caught off guard and surprised by Lula’s approach toward the sector, given his strong support for the overall concept. The leader of one microfinance institution put it this way: “When the Lula

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31 Perhaps the most extreme example, during the campaign for his reelection, Lula reportedly ran a television announcement in which he boasted about providing microfinance to a start-up bikini factory (Halliday 2006).
government began, that’s when the persecution of the [microfinance] institutions began” (MF15).

With little access to the Lula administration, the sector began to organize in response. A few leaders from the microfinance sector created one microfinance association for SCMs, the Brazilian Association of SCMs, (ABSCM, Associação Brasileira das Sociedades de Crédito). Shortly thereafter, another association formed to represent the OSCIPs, the Brazilian Association of Microcredit Entities (ABCRED, Asociación Brasileña de Entidades de Microcrédito). Though both associations exist today, they play only a marginal role in shaping the microfinance sector.

The owner of the first SCM authorized by the Central Bank created ABSCM. The purpose of the organization is to unite all SCMs in an umbrella organization (MFA2). In 2007, five individuals—each of who own an SCM—assumed the leadership of ABSCM to “try to make some progress in the regulatory framework [for SCMs], which were not doing well, even after a decade since their creation” (MFA2). ABSCM has had little luck. Their humble infrastructure mirrors its weak position relative to the state. ABSCM does not have an office nor does it collect dues (and thus have its own budget) from member institutions. Thus, there are no employees dedicated specifically to its work. Any effort to reach out to state actors is a cost that rests on the shoulders of the five individuals that share the leadership of ABSCM (MFA2). As of 2007, ABSCM had only eight member institutions.

The second association—ABCRED—aims to coordinate all other microfinance institutions that are not SCMs. This association, however, is loosely organized and has not been particularly influential in affecting state policy. Similar to ABSCM, ABCRED does not have a strong institutional framework nor does it have any employees. It does not gather dues from its member institutions. One interviewee from the sector reported that “ABCRED does not have a proper working infrastructure—it doesn’t have any money. Everyone who [belongs] has another full-time job; they have other things to do” (MFI9).

Rather than observing a clear sector-wide strategy as seen in the Mexico case, many ABCRED members rely on individual connections to the Worker’s Party in general and President Lula in particular. Such personal relationships proved instrumental in ABCRED’s ability to gain small regulatory concessions, but ultimately ineffective in influencing the broader changes desired by the microfinance sector. The following example illustrates this point.

Shortly after assuming office, the Lula administration lowered the interest rate caps that could be applied to government funding—restricting it to two percent per month. Given the primary source of funding is from the government, institutions had to comply with these rates. The president of ABCRED, José Caetano Lavorato, explained that the sector was crumbling under the *de facto* interest rate and needed to charge higher
interest rates to make ends meet. ABCRED tried multiple times to contact Lula or others close to the president, but with no success. After two years of trying to address this issue, Lavorato discovered that Lula would be traveling to Beijing for three days. Lavorato recounted that an old friend from the airline union was able to provide a heavily discounted flight to China where Lavorato proceeded to follow Lula and his staff as much as possible. At one moment—in the hallway of a Beijing hotel—Lula called to Lavorato and said “I see you are here. What can I do?” Lavorato, having just a brief moment, recalled saying, “You have to do something about these interest rates,” to which Lula replied, “I’ll put my top guy on it.” Shortly thereafter, the limit on interest rates was raised to four percent per month for loans above R$1,000 and below R$10,000. Loans below R$1,000—that are more costly and are likely to go to low-income individuals—still carry a two percent interest cap (Kumar 2005; Meagher, et al. 2006). While this change eased the situation for some microfinance institutions, it also meant that microfinance institutions had a greater incentive not to lend to the poorest of the poor. These individuals would require smaller loans, on which, given the interest rate cap, microfinance institutions would be unlikely to cover costs.

Though Lula provided minimal concessions with regard to interest rate caps, no movement was made on the issue of savings. One interviewee noted, “[i]f we could access savings, offer that product to people, we would be less dependent on the government and could expand” (MFI3). With access to savings, microfinance institutions would have some sense of stability. They would be able to forecast the value of their portfolio and expand their services accordingly. Another director of a microfinance sector said: “We don’t want subsidized funding, we want real funding, with normal interest rates,” explaining that market rates would ultimately improve the competitiveness and efficiency of the sector (MFI1).

With little access to the state, microfinance providers overcame their collective action problem. Similar to their Mexican counterparts, dissatisfaction with the regulatory environment and lack of state access increased their incentives to do so. Even so, the organizations that formed were weak and relatively ineffective. Any regulatory changes that were made were quite minimal and certainly did not significantly alter the state’s approach to microfinance. While these actors overcame their collective action problem, they were not influential. Indeed, these actors have not negotiated with the state, but rely on key members’ connections to upper-level government officials. In sum, they have not adopted influential strategies that would allow them to counter the Brazilian state.

**DISCUSSION & FUTURE RESEARCH**

This research highlights the importance of organized interests in shaping microfinance regulatory environments. In doing so, it makes important theoretical and empirical
contributions. Empirically, this is the first study of its kind to assess the macro-politics of microfinance. This paper makes a number of important theoretical contributions, as well.

First, this research illustrates that organized interests co-evolve with the state. My argument, in its most basic form, is displayed in Figure 1. There are two possible scenarios through which microfinance regulation is determined (A and B in Figure 1). What is notable about both depictions, however, is that the state and the microfinance sector co-evolve. The term co-evolution is especially appropriate because it acknowledges that each actor is shaped by the other. It also allows for suboptimal outcomes; that is, actors might evolve in imperfect ways. The study highlights the feedback effect between state actors and domestic interests. It incorporates, rather than avoids, the co-evolving nature of this relationship. In scenario A below, the microfinance sector moves first. This influences the state’s reaction, which in turn affects the microfinance sector. This feedback effect occurs numerous times. In scenario B, the state moves first, which influences the microfinance sector. The evolution of the microfinance sector, in turn, affects the actions of the state. Again, this process can also occur multiple times.

Co-evolution also encompasses actions that can occur through contestation or acquiescence, as discussed in the case studies above. Access to the state, for example, can shape the organization of domestic interests just as the organization of domestic interests can shape access to the state. Indeed, this study illustrates how state action can actually thwart, not bolster, the organization of domestic interests. When domestic actors have access to the state, there is little incentive to organize. Alternatively, the presence of well-organized domestic interests can secure access to the state for those that were previously unable to directly engage with the state.

[Figure 1 here]

In Mexico (captured by scenario A in Figure 1), this process meant the microfinance sector organized into microfinance associations due to the perceived threat from the state and its oscillation between action and inaction. In the 1990s, various microfinance providers evolved into microfinance associations and consolidated as a sector. These partnerships, however, did not dissolve once the state threat had subsided. Indeed, microfinance associations in Mexico played a leading role in influencing the regulatory regime. This research suggests that state inaction is just as crucial as state action in explaining the ability of domestic interests to organize and, ultimately, effectively influence microfinance regulatory outcomes.

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32 This conceptualization of state-society relations resonates with Migdal’s (2001) state-in-society research. Indeed, he states: “Countries’ stories do not end with the original sin or the critical juncture where there is the imposition of a powerful normative force; they only begin, for those forces call into being resistance and struggle, cooperation and coalitions, that transform the original impulse” (25).
In Brazil (captured by scenario B in Figure 1), alternatively, the state took an early interest in promoting the microfinance sector. Brazilian microfinance institutions, unlike their Mexican counterparts, had relatively open access to the state and, thus, few incentives to organize. As discussions surrounding the microfinance regulatory environment began through the Solidarity Community, microfinance institutions were invited to partake. This state-led process meant microfinance providers had a seat at the table and could access top officials. Given the sector’s access to the state, the small set of homogenous actors did not organize amongst themselves despite not being able to achieve their preferred policy outcomes. State access resulted in the evolution of a weak microfinance sector; a frail counterpart resulted in the evolution of a strong state within the microfinance sector.

The second theoretical contribution of this research is that it identifies an important analytical distinction between collective action and collective influence. This perspective changes how we conceive of organized domestic interests. It is important to recognize that the two are not the same; a group that overcomes its collective action problem may not be influential. We know that not all groups are able to obtain their desired outcome and, as such, it is helpful to conceive of these as two separate processes. Those characteristics that allow a group to organize, for example, may not be the characteristics that facilitate its achievement of its preferred outcomes.

Finally, by uncovering new, innovative tactics used by microfinance associations to influence policy outcomes, this research offers a new perspective on organized interests in emerging economies. Turning to Mexico, microfinance associations’ ability to satisfy their policy preferences was not only due to their ability to organize, but the structural characteristics and innovative strategies they employed to boost their bargaining power relative to the state. Organized groups’ ability to “collectively influence” was due, in part, to those characteristics thought to inhibit collective action: their large size and their heterogeneity. In addition, Mexican microfinance associations adopted a systematic, research-based approach that targeted mid-level bureaucrats—not powerful politicians. This move alone meant that by the end of the decade, organized groups had buy-in from government officials across a number of important state departments. They strategically sought the expertise of bureaucrats as a cautionary measure against the political pull of politicians.

Ultimately, the organization of domestic actors, in turn, influences the regulation that policymakers adopt. Where domestic actors do not organize, states will likely implement a state-supported approach to microfinance; where actors are organized, they can check state power and promote a financial-systems approach to microfinance. Theoretically, the arguments presented here about the formation of domestic interests and their ability to influence the state raise important implications regarding the potential quality and strength of democracies and prospects for development. This set of claims,
for example, may pick up where Bates (1981) left off. Bates illustrated that organized
groups at the domestic level (middlemen) explain the underdevelopment of African states
by lowering incentives for producers to organize. In the case of microfinance,
alternatively, the formation of organized interests that aim to serve the poor—even in the
context of strong states—could have important implications for the shape of democracy
and the distribution of its benefits.
REFERENCES


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Meagher, Patrick et al. 2006. “Microfinance Regulation in Seven Countries: A Comparative Study.” Report from IRIS, University of Maryland.


### TABLE 1: Microfinance Associations in Mexico (as of December 2000)

<table>
<thead>
<tr>
<th>MF Association</th>
<th>Year Formed</th>
<th># of Institutions</th>
<th>Members/ Clients</th>
<th>Loans Granted</th>
<th>Branches</th>
<th>Employees</th>
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<tbody>
<tr>
<td>CMCP</td>
<td>1964</td>
<td>n/a</td>
<td>726,027</td>
<td>661,626</td>
<td>575</td>
<td>3,406</td>
</tr>
<tr>
<td>AMUCSS</td>
<td>1990</td>
<td>32</td>
<td>75,000</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>ANURCO (from CMCP)</td>
<td>1993</td>
<td>57</td>
<td>243,864</td>
<td>171,762</td>
<td>55</td>
<td>720</td>
</tr>
<tr>
<td>AMSAP (from CMCP)</td>
<td>1994</td>
<td>12</td>
<td>153,549</td>
<td>89,958</td>
<td>62</td>
<td>675</td>
</tr>
<tr>
<td>ProDesarrollo*</td>
<td>1997</td>
<td>n/a</td>
<td>263,056</td>
<td>n/a</td>
<td>136</td>
<td>1,346</td>
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<tr>
<td>La Colmena Milenaria</td>
<td>1998</td>
<td>8</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>CCACEUM</td>
<td>n/a</td>
<td>n/a</td>
<td>436,229</td>
<td>220,115</td>
<td>132</td>
<td>1,350</td>
</tr>
</tbody>
</table>

Source: Adapted from O’Keefe 2007; *Not all members contributed to these data presented here.

### Figure 1: Schema of the Argument

A) MF Sector → State → Regulation

B) State → MF Sector → Regulation
APPENDIX A: INTERVIEWS CONDUCTED (2008-2009)

Table A1: Interviews Conducted (Mexico)

<table>
<thead>
<tr>
<th>Reference Code</th>
<th>Interviews Conducted</th>
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<tr>
<td>Microfinance Association</td>
<td>MFA</td>
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<tr>
<td>International Community</td>
<td>I</td>
</tr>
<tr>
<td>Formal Financial Sector</td>
<td>F</td>
</tr>
<tr>
<td>State</td>
<td>S</td>
</tr>
<tr>
<td>Academic</td>
<td>A</td>
</tr>
<tr>
<td><strong>Total Interviews</strong></td>
<td></td>
</tr>
</tbody>
</table>

Table A2: Interviews Conducted (Brazil)

<table>
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<th>Reference Code</th>
<th>Interviews Conducted</th>
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</thead>
<tbody>
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<td>Microfinance Sector</td>
<td>MFI</td>
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<td>Microfinance Association</td>
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<td>State</td>
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<td>A</td>
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<tr>
<td><strong>Total Interviews</strong></td>
<td></td>
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</tbody>
</table>