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INTERNATIONAL TRADE FOR POVERTY ALLEVIATION

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## International Microtrade Regime – Structure and Financing

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# International Microtrade Regime – Structure and Financing

Arpita Gupta

## Abstract

The conceptualization of a new form of trade, microtrade, is visualized to hold great promise in economic development of the producers belonging to LDCs and developing countries. In order to meet the goal of poverty reduction at a sustainable pace, the institutional, financial and logistical mechanisms for facilitating microtrade both at the international and national level needs to be built in a manner which ensures maximum efficiency. The paper deals with two fundamental aspects of development of microtrade. First, it delineates different aspects which would provide a strong substratum to the proposed microtrade regime. It explores the legal and institutional framework required for conduct of microtrade, which can be structured under the existing WTO regime and proposes necessary amendments to the WTO regime. Second, the paper explores financial aspects of the proposed microtrade regime. A case study of operation of micro-credit in the Indian scenario is undertaken in order to highlight the problems which have recently emerged in the microfinance sector. The scale of these problems has led the Indian government to propose a bill, regulating microfinance in India. Cue from this experience needs to be taken in order to move towards a foolproof system of financing microtrade at the local level.

**KEYWORDS:** microtrade, poverty alleviation, microfinance

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## I. INTRODUCTION

The statistics on the current state of poverty in the Least Developed Countries and most developing countries are alarming. They belie the hope of fulfillment of the primary UN Millennium Development Goal of poverty alleviation by the year 2015.<sup>1</sup> This necessitates the exploration of new means of removal of constraints other than the existing means in order to inch towards poverty alleviation. The present trend in developmental studies supports decentralized mechanisms for development and proposes measures to be taken at the grass root level. This bottom-up approach is commensurate with the goal of preservation of diversity and application of different approaches as per specific requirements of different regions.

The conceptualization of a new form of trade, microtrade,<sup>2</sup> trading of artifacts produced primarily through labor intensive techniques is visualized to hold great promise in economic development of the producers belonging to LDCs and developing countries. Promotion of such a trade would also aid in preservation and continuance of some of the invaluable aspects of human heritage which might otherwise be lost forever. In order to meet the goal of poverty reduction at a sustainable pace, the institutional, financial and logistical mechanisms for facilitating microtrade both at the international and national level needs to be built in a manner which ensures efficiency and accrual of substantial benefits to the producers.

This paper is broadly divided into three parts. It is partly a response paper to the novel concept of international microtrade, introduced by Y.S. Lee.<sup>3</sup> The first two parts build upon the model microtrade regime proposed by Lee. Part I of the paper explores certain pertinent issues relating to the definition of microtrade and exhorts the possibility of widening its ambit. Part II deals with the overall

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<sup>1</sup> Scholarly literature and empirical studies on the progress achieved in fulfilling the Millennium Development Goals abound. See Thomas Pogge, *The First United Nations Millennium Development Goal: A cause for celebration?*, 5 *Journal of Human Development*, no.3 (2010), 377-397. Patrick Bond, *Global Governance Campaigning and MDGs: from top-down to bottom-up anti-poverty work*, 27 *Third World Quarterly*, no.2 (2006). Jan Vandemoortele, *The MDG Conundrum: Meeting the Targets Without Missing the Point*, 27 *Development Policy Review*, no. 4 (2009), 355-371. Robyn Dixon, *U.N. Millennium Development Goals appear out of reach in Africa*, *Los Angeles Times*, 20. September 2010.

<sup>2</sup> Microtrade would further the larger study of linkage between trade and sustainable development. For an overview of the relation between trade and development, see Emmy B. Simmons, *Linking Trade and Sustainable Development: Keynote Address*, 18 *American University International Law Review* (2002-3).

<sup>3</sup> Yong-Shik Lee, *Theoretical Basis and Regulatory Framework for Microtrade: Combining Volunteerism with International Trade towards Poverty Alleviation*, Law and Development Inaugural Conference (October, 2010), text available at: <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1524185](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1524185)>.

institutional and regulatory framework of international microtrade. Part III juxtaposes the concept of microtrade with microfinance, explores the similarities and symbiotic relation between the two; and through a specific case study of microfinance related crisis in the State of Andhra Pradesh in India, point out some of the experiences undergone in the realm of microfinance, which would be helpful in designing a better microtrade system.

## **II. WHAT IS MICROTRADE?**

### **A. The ‘micro’ in microtrade**

The prefix ‘micro’ has been conventionally used to impart a specific meaning to a word. It has three dimensions which serve to sketch broader confines of definition of the word. First, in terms of quantity and scale, it refers to a unit of measurement which is usually the smallest self-sustaining block. Second, it gives a sense of gradation in the levels of operation of an activity (in this case, trade). A micro level posits itself in contrast with the macro in terms of quantity, linkages and control mechanisms. Third, following from this binary differentiation is the aspect of ‘informal’ associated with the micro as opposed to the usual association of ‘formal’ with micro.<sup>4</sup> The informal-formal dichotomy is generally applied to distinguish mainstream sectors of economy, finance etc. from the parallel sectors, which do not operate on large scale. Often, the ‘micro’ level is left unregulated due to small overall quantitative and financial contribution towards both the global and national economy.

But, the recent usage of the suffix ‘micro’ shows that a new dimension has been adduced to its meaning. This new dimension reflects a welfare orientation. It signifies the attempt to empower those at the grass root level and those who fall outside the general economic and financial activities and facilities. Products like microfinance and micro-insurance have been especially designed to cater to needs of those who, for various reasons are not in a position to avail these services. Going beyond the profit orientation of most business models, the meta-purpose behind this development is to assist people belonging to generally low income level, in moving out of poverty in a sustainable manner. It provides different modes of linkages between the macro level and the micro level of the economy. Microtrade too is conceived as a facilitative mechanism to improve financial

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<sup>4</sup> For a theoretical discussion on the concepts of formality and informality, see Alice Sindzingre, “The Relevance of the Concepts of Formality and Informality: a Theoretical Appraisal,” in Basudeb Guha-Khasnobis et al. (eds.), *Linking the Formal and Informal Economy: Concepts and Policies* (Oxford: Oxford University Press, 2006).

status of people afflicted with poverty, especially in less developed parts of the world.<sup>5</sup>

## B. Microtrade vs. fairtrade

The concepts of microtrade and fairtrade<sup>6</sup> are meant to serve similar ends, i.e. augmenting financial capacity of producers by helping them get a decent price for their products in the market. The fairtrade system has been well established and the new microtrade regime can benefit from the experience undergone in the field of fairtrade. There are certain important similarities as well as differences between the two concepts. The former has been envisaged to serve the producers of mainly nonagricultural LLPs (locally produced products),<sup>7</sup> whereas the latter serves mainly small agricultural producers. The former is applicable to labor intensive products manufactured in Least Developed Countries (LDCs), while the latter seeks to provide fair price to the marginalized small scale producers right from LDCs, developing countries to the developed countries.

There are numerous organizations<sup>8</sup> which provide training, credit, distribution and certification services for products to be traded under fairtrade both nationally as well as internationally. Farmers belonging to many LDCs, especially those producing organic beverages, spices, grains etc. benefit under the current fairtrade regime, through sale of their products in developed countries.<sup>9</sup> This is done, in spite of the stringent SPS requirements in developed countries. Thus, the ambit of microtrade can be expanded to include agricultural goods

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<sup>5</sup> See *Supra* note 3.

<sup>6</sup> Fair trade has been developed as a tool to aid marginal producers especially from the global south, seeking to impart equity to international trade. See Geoff Moore, *The Fair Trade Movement: Parameters, Issues and Future Research*, *Journal of Business Ethics* (2004). Joseph Stiglitz and Andrew Charlton, *Fair Trade for All: How Trade Can Promote Development* (2005). Janet Dine, *Democratization: the Contribution of Fair Trade and Ethical Trading Movements*, 15 *Indiana Journal of Global Legal Studies* (2008), pp. 177-211.

<sup>7</sup> *Supra* note 3, at 5.

<sup>8</sup> The "...social economic and environmental aspects of production are certified against Fairtrade Standards for Producers and buying and selling is certified against Fairtrade Standards for Trade" by various certification organizations. Fairtrade Labeling Organizations International, the largest certification organization for fair-trade products worth \$ 4.5 billion were sold the world over, see Fairtrade International, *Facts and Figures*, available at, <<http://www.fairtrade.net/361.html>. >

<sup>9</sup> Companies with wide global presence like Starbucks and the Body Shop have started procuring their raw materials through fair-trade. See e.g.: <<http://www.thebodyshop-usa.com/values-campaigns/community-trade.aspx>> <<http://www.starbucks.com/responsibility/sourcing/coffee>.>

along with ‘portable items of every-day use.’<sup>10</sup> This would lead to a substantial increase in scope of goods which can be traded under microtrade and increase the overall turnover realized by LDCs through export of different products.

Primarily, due to the geographical factors many LDCs are capable of producing one or two primary kinds of crops. Thus, the testing required to be done for fulfilling SPS requirements under the WTO does not pose a major hurdle in terms of testing costs. Under the WTO, a permanent group of experts can be designated for carrying out regular checks and in case of violation of these requirements, advice these LDCs means through which these technical requirements can be satisfied. Due of their developmental status, the major sector of employment for majority of the population in the LDCs is the primary sector.<sup>11</sup> Article XXXVI(4) of the GATT<sup>12</sup> too, acknowledging this fact urges other contracting parties to provide “more favorable and acceptable conditions of access to world markets for these products” and devise measures to attain objectives like “stable, equitable and remunerative prices.” Thus, excluding this crucial sector from microtrade would considerably weaken the effect of poverty alleviation effort, which is the primary goal behind the conception of microtrade. Furthermore, there might not be a substantial and well distributed production of daily use LPPs like utensils, furniture etc. for warranting long and consistent sustainability of trade for the majority of target population. In case of perishable agricultural products, a better strategy would be to encourage setting up of basic processing facilities to convert perishables into products with a longer shelf life.<sup>13</sup>

In most of the LDCs, there is at least a minimal presence of NGOs working for economic upliftment of the local communities.<sup>14</sup> These, along with the fairtrade organizations working in the country or in the neighboring parts can be looped in to aid in operation of a successful microtrade regime.<sup>15</sup> They can provide the necessary knowledge and data about the local conditions prevalent in a country, export prospects, distribution networks and most importantly,

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<sup>10</sup> *Supra* note 3, at 6.

<sup>11</sup> See Bruce F. Johnston and John W. Mellor, *The Role of Agriculture in Economic Development*, 51 *The American Economic Law Review*, no.4 (2007), 566-593.

<sup>12</sup> See GATT, Art. XXXVI, Principles and Objectives.

<sup>13</sup> A number of NGOs the world over are involved in training people in processing locally produced primary products into products which can be sold in the market, to help the poor supplement their income. See, for e.g., *Success Stories: A Few Case Studies*, Planning Commission of India Reports, available at: <[http://planningcommission.nic.in/reports/sereport/ser/7vgtm/v3\\_ch10.pdf](http://planningcommission.nic.in/reports/sereport/ser/7vgtm/v3_ch10.pdf)>.

<sup>14</sup> These NGOs and IGOs work closely with the local communities residing in the less privileged parts of the world. The primary emphasis of their work is to create sustainable employment opportunities locally.

<sup>15</sup> See Susan Arien Aaronson and Jamie M. Zimmerman, *Fair Trade? How Oxfam Presented a Systemic Approach to Poverty, Development, Human Rights and Trade*, 28 *Human Rights Quarterly* (2006), 998-1030.

certification facilities for ensuring the origin, quality and non-commercial production of the goods to be exported under the aegis of microtrade.

### C. The economic viability of microtrade and the target population groups

Keeping into consideration some of the important factors like production, distribution, transportation, and regulatory costs; the economic viability of microtrade in a country has been worked out to be determined from the following equation:

$$E_m = (P_f \times Q_f) - C_{p,d,s,r} \text{ where } E_m \geq E_d \text{ and } E_m \geq E_o^{16}$$

An important consideration in the above equation is  $E_o$ , which refers to employment opportunities other than microtrade. It is proposed that in the event that the earning received by a producer from this alternative economic opportunity is more than what can be earned through microtrade then it would not be worthwhile to get involved in microtrade. The types of alternative employment envisaged here are jobs such as working in a factory or immigrating to another country for work. Usually, it is the male family members who stand a possibility of taking up such alternative employments. But, in a poor household, earning by just one family member is not enough. The family income has to be substituted by additional means. Female members of a family are usually not as free to migrate for work as their male counterparts. Yet, for sustenance, they need to undertake odd jobs to supplement the family income. If they undertake work, like handicraft production and processing of primary products grown locally, they can fulfill both the requirements of working from or near to the home and supplementing the family income. Thus, even in cases where there is possibility of earning more through alternative employment opportunities, than what one would earn through microtrade, if not as a primary source of income, microtrade can prove to be very useful at least as a supplementary source of income for the household. In such cases, women can be made the primary focus of microtrade initiatives. Many NGOs are operating in LDCs with this very purpose and have made commendable inroads in this direction through training programs, supply and distribution chains

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<sup>16</sup> *Supra* note 3, at 7. In the given equation,  $E_m$  signifies earning for the LDC producer from microtrade;  $P_f \times Q_f$ , the total revenue generated in the foreign market;  $C_p$ , the cost of production;  $C_d$ , the cost of distribution;  $C_s$ , the shipping cost;  $C_r$ , the regulatory cost;  $P_f$ , the price in the foreign market;  $Q_f$ , the quantities sold in the foreign market;  $E_d$ , the earning retained by LDC producer from domestic sale of LPP and;  $E_o$ , the earning from the alternative employment opportunities, other than microtrade.

for the sale of local produce abroad etc. Adoption of a women centric approach would serve additional purposes like economic empowerment of women, promotion of certain good values and preservation of some aspects of culture as well.

The economic equation for viability of microtrade would work well even in this form:

$$E_m = (P_f \times Q_f) - C_{p,d,s,r} \text{ where } E_m \geq E_d$$

Further, due to high costs of production, distribution, shipping and regulation; even if the net result after applying the equation to a particular scenario comes out to be negative or near zero, the idea of microtrade need not be abandoned. This is primarily a welfare oriented measure, designed towards attaining an important millennium development goal (MDG) of poverty alleviation. The necessary infrastructure and distribution network for the proposed microtrade regime can be built through the funds meant for achieving MDGs<sup>17</sup> generally and for poverty alleviation<sup>18</sup> specifically. An international subsidization initiative would be necessary in building up an international microtrade regime.

As shown above, economic empowerment of women through microtrade makes good sense even in cases where some members of a poor household can earn more from other sources of employment. The main objective of microtrade is to help alleviate poverty in LDCs. Recent studies have moved beyond the conventional definition of poverty, which was solely based on economic criterion. Now, the emphasis is towards removal of multidimensional poverty<sup>19</sup> which is determined by ten indicators based on three dimensions- health, education and living standards. It has been shown that in case of developing and Least Developed countries, where these indicators are anyway poor, the health, education and living standards for women are even lower than the national

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<sup>17</sup> See, The IMF and the Millennium Development Goals, Factsheet (August 31, 2011), available at: < <http://www.imf.org/external/np/exr/facts/mdg.htm>>;

See also A. B. Atkinson, *Funding the Millennium Development Goals: A Challenge for Global Public Finance*, 14 *European Review* (2004), 555-564.

<sup>18</sup> MDGIF, MDG Achievement Fund, available at: <<http://www.mdgfund.org/>>

<sup>19</sup> Multidimensional Poverty Index, introduced in 2010 by the UNDP supplanted the Human Poverty Index. It acknowledges that poverty is multi-dimensional and mere money based measures are not enough to gauge the extent of poverty. It comprises of a survey of three dimensions namely health, education and living standards which are further divided into the following ten indicators- nutrition, child mortality, years of schooling, children enrolled and availability of cooking fuel, toilet, water, electricity, floor and assets. According to the UN Human Development Report 2010, about 1.75 billion people in the 104 countries covered by the Multidimensional Poverty Index are reeling under poverty, living on less than \$1.25 a day. More than 30 percent of the indicators reflect acute deprivation in health, education and standard of living. See United Nations Development Programme, Human Development Report 2010, at 86.

average. Thus, within the general goal of poverty alleviation, a differential approach based on needs of different social groups in a society is required to be adopted. The economic and the consequent social empowerment of women as a result of special focus of microtrade initiatives would comprise a significant step towards countering multidimensional poverty.

This would also lead to promotion of certain values which are considered to be beneficial in their own right, like increased availability of organic food in the market and availability of non-genetically modified indigenous varieties of primary products. This would also result in prevention of loss of genetic diversity<sup>20</sup> of these indigenous crop varieties. The certification of these products would also give the consumers in the developed countries a wider range of product choice<sup>21</sup> with regard to the place and mode of origin of the products; as well as the diversity in form of different sub-species of a particular crop.

Another valuable upshot of such an international trade regime, especially in case of products like handicrafts and tangible art forms is that it would help preserve some valuable material aspects of culture in the LDCs which otherwise might have been lost to the humanity due to absence of incentives to continue their production. The comprehensive database of tradable products to be prepared and the trade of these products under the microtrade regime would help in the conservation of the cultural heritage of these countries. The extensive work done by various international and regional organizations working towards preservation of tangible elements of culture<sup>22</sup> would provide a solid foundation to the trade and conservation efforts undertaken under this new regime.

#### **D. Towards a more inclusive membership of the microtrade regime**

The microtrade regime has been envisaged exclusively for the LDCs.<sup>23</sup> Microtrade regime, which this paper proposes to be constituted as part of the

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<sup>20</sup> A considerable amount of scientific research has been conducted in studying the occurrence of loss of genetic diversity of plants. See generally, A C Newton, *Cereal Landraces for a Sustainable Agriculture*, 30 *Agronomy for Sustainable Development*, no.2 (2010), 237-269. Geoffrey Heal et al, *Genetic Diversity and Interdependent Crop Choices in Agriculture*, 26 *Resource and Energy Economics* (2004), 175-184.

<sup>21</sup> See William Low and Eileen Davenport, *To boldly go...exploring ethical spaces to re-politicise ethical consumption and fair trade*, 6 *Journal of Consumer Behaviour*, no.5 (2007), 336-348.

Michele Micheletti and Andreas Follesdal, *Shopping for Human Rights. An Introduction to the Special Issue*, 30 *Journal of Consumer Policy*, no.3 (2007), 167-175.

<sup>22</sup> These tangible aspects of culture largely constitute of locally produced traditional art and craft objects, which are primarily known as the handicrafts and are sought to be conserved.

<sup>23</sup> *Supra* note 3, at 3.

World Trade Organization, should not exclude the 17 WTO non-member LDCs out of a total of 49 LDCs in the world.<sup>24</sup> The larger goal of poverty alleviation in the least developed parts of the world requires that there should be no discrimination merely on basis of WTO membership. Thus, all LDCs should essentially be covered under the microtrade regime.

At the initial stage of development, the microtrade regime can be limited to LDCs. But, once the regime has been successfully established, then an endeavor should be made to include the poor in non-LDC developing countries as well. This is because in absolute terms the number of poor people living in non-LDC developing countries is more than the total number of poor inhabiting the LDCs.<sup>25</sup> If the aim of this regime is substantial reduction of global poverty, then such a large part of global population afflicted by severe poverty cannot be excluded from the benefits of global poverty control efforts.

The priority given to the LDCs under international microtrade is justified. These countries suffer from economic setbacks such as lack of capital, infrastructure, and technology which cumulatively have an inhibitory effect on overall economic development of the country. This is not necessarily the situation in case of those developing countries which are experiencing a fast economic growth. But, a large part of population there too is suffering from poverty, and a need for an international level assistance is felt. Though LDCs deserve special status under the proposed microtrade regime, a limited and well regulated space can be made available for participation of poor from developing countries as well. These limitations can be based on the kind, quantity, and origins of products to be traded. In a situation where there are similar products available from both an LDC and a non-LDC, *and* there is a quota restriction, then preference should be given to the products originating from the LDC. When there is no competition between the products originating from LDCs and developing countries in the market of importing countries, the products from non-LDC developing countries can be allowed to be traded under the new regime. Depending upon the situation, limitations based on product categories like agricultural products or handicrafts can be imposed. Handicrafts from non-LDC developing countries are more likely to be permitted trading under microtrade because due to their endemic origins they are unlikely to directly compete with handicrafts from other regions. The certification and labeling services will play a significant role here too. The labeling on a product would clearly specify the

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<sup>24</sup> See LDC Statistical Pocket Book 2010, UN-OHRILLS, available at:  
<<http://www.unohrills.org/UserFiles/File/LDC%20Pocketbook2010-%20final.pdf>>.

<sup>25</sup> For instance, India is home to one third of world's poor. See, *The World Bank in India, Issue Brief* (September, 2004), available at:  
<[http://siteresources.worldbank.org/INTINDIA/Data%20and%20Reference/20283013/Poverty\\_In dia\\_Brief.pdf](http://siteresources.worldbank.org/INTINDIA/Data%20and%20Reference/20283013/Poverty_In dia_Brief.pdf)>

country of origin of the product, that it was not mass produced and that the aim behind this trade is to benefit people from less developed parts of the world who are facing economic distress. This new trade would depend a lot on customer goodwill. But, this should not be a cause of worry as many market studies reveal that there is an increased move towards 'ethical' or 'conscientious' consumerism in global north.<sup>26</sup>

Microtrade products are envisaged to be sold in markets of the developed countries.<sup>27</sup> But, the recent trend towards the global south-south cooperation and the increasing role of some fast growing developing economies at the international level show that the developing countries too can prove to be of great assistance to the LDCs.<sup>28</sup> Due to a greater proximity of LDCs with developing countries as compared to the developed countries in terms of political, social and economic realities, the developing countries can understand the developmental needs of LDCs better and provide financial and technological assistance along with market access to their products. As a result of similarity in experiences and conditions, the idea of 'horizontal learning'<sup>29</sup> amongst the countries of the global south, has been mooted under the aegis of the new law and development movement.<sup>30</sup>

### **E. Need for regulation of microtrade?**

The question of whether microtrade should be regulated or not becomes part of the larger debate on desirability or non-desirability of regulation in general.<sup>31</sup> It is

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<sup>26</sup> For e.g., see Kevin Morgan, *Local and green: Global and Fair: the Ethical Foodscape and the Politics of Care*, 42 *Environment and Planning* (2010), 1852-1867.

<sup>27</sup> *Supra* note 3, at 6.

<sup>28</sup> Such south-south cooperation efforts are on a rise. Efforts at the level of government, academics as well as economy are being made to promote this cooperation agenda. For instance, the recent India-LDC Ministerial Conference held in Delhi in February 2011, stated its objective as "harnessing the positive contribution of south-south cooperation for development of least development countries." Among other things the agreement reaffirmed the commitment to facilitate food security, poverty reduction and enhance investment for the development of LDCs, available at: <<http://india-ldc.nic.in/declaration.pdf>>.

<sup>29</sup> Under the new law and development movement, horizontal learning has been devised as an important mechanism of development of the global south. See David M. Trubek, *21<sup>st</sup> Century Law and Development* (Sept. 13, 2011), available at: <<http://www.law.wisc.edu/gls/bricslaw.html>>.

<sup>30</sup> See, David M. Trubek and Alvaro Santos (eds.), *The New Law and Economic Development: A Critical Appraisal* (2006).

<sup>31</sup> For a comprehensive idea of the debate between various schools of thought over desirability/undesirability of regulations in general, see Andrei Schleifer, *Understanding Regulation*, 11 *European Financial Management*, no.4 (2005), 439-451.

surmised by a class of economists that values which are desirable get promoted in an open environment and they do not need regulation for their promotion. But, this approach cannot be applied in case of microtrade. The microtrade regime, because of its special purpose and significance, needs facilitative regulation, both at the domestic and the international level. Due to its welfare orientation, it might not be able to sustain itself without a regulatory mechanism. Because microtrade is a new form of international trade it requires an efficient organizational and legal structure at the international sphere, which would become possible only with the help of a comprehensive regulatory framework. The requirement of an international regulatory framework becomes even more apparent because of reasons like political instability, lack of power and resources with the state governments to enforce rules<sup>32</sup>; regulation at the domestic level would not have the desired effect of microtrade promotion. Even if the state government in an LDC manages to come up with a domestically effective regulation, due to the transnational nature of microtrade, domestic regulation would not be sufficient to promote it. Apart from having regulations at the international level and within the exporting LDC, facilitative regulations in the countries of import would serve to provide a big boost to microtrade.

### **III. ORGANIZATIONAL ASPECTS OF INTERNATIONAL MICROTRADE: INSTITUTIONAL AND REGULATORY FRAMEWORK**

#### **A. Institutional framework**

The new international microtrade regime would require a considerable organizational setup. It would govern trade of locally produced products from 49 LDCs to the other parts of the world. It would need a specialized workforce to look after its functioning. The major functions of this institutional arrangement would be to prepare and amend through a research center, a database<sup>33</sup> of products which can be traded under microtrade; establish the initial facilities for transport, distribution and financing of production and trade; to network with NGOs working in LDCs and other international organizations involved in poverty

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<sup>32</sup> *Supra* note 3, at 4.

<sup>33</sup> The preparation of this data process would involve detailed research in all the LDCs of the world. Partnering with the organizations working orally would be of great assistance. There would also be a need of innovative thinking in terms of making these locally produced goods, suitable to the consumers globally.

alleviation; and ensure the proper functioning of this trade regime by conducting periodic reviews and suggesting the necessary amendments.

1. Should the microtrade regime be a part of WTO or be independent of it?

For supervising microtrade, two possible alternatives have been proposed;<sup>34</sup> first, creation of a separate international organization; and second, regulation under the existing WTO framework. Developing a new microtrade regime under the aegis of WTO would decidedly have multiple advantages.

Carving out a new microtrade system directed towards alleviation of poverty from less developed parts of the world within the existing WTO framework would form a part of the larger program of reform of international organizations. The economic and political asymmetry<sup>35</sup> between the global north and the global south has triggered powerful reactions from global south, favoring organizational and structural reform of major international organizations,<sup>36</sup> so as to reflect a more equitable balance of power between different parts of the world. WTO too has come under criticism from many trade law scholars who point out the inequitable effects of the current WTO regime over developing regions of the world.<sup>37</sup> Instead of creating new international organizations, it would be more expedient to attempt reform of the existing ones. This would also prevent further fragmentation of international law and thus the consequent friction between its various components. Establishing a trading system like microtrade would serve to give the LDCs an important role in WTO and the underlying objectives behind this new regime would also influence the working of WTO in general.

Microtrade would not operate in a vacuum. It would take place in an economic scenario where there are other kinds of commercial interactions taking place at the international level, like the mainstream trading under the WTO and under non-WTO arrangements like Free Trade Agreements, Customs Unions etc. The WTO, which occupies a significant space and plays an important role in

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<sup>34</sup> *Supra* note 3, at 14.

<sup>35</sup> See for instance, J. Timmons Roberts, Bradley C. Parks, *A Climate of Injustice: Global Inequality, North-South Politics, and Climate Polic.* Nancy L. Stokey, *The Volume and Composition of Trade Between Rich and Poor Countries*, 58 *Review of Economic Studies*, no.1 (1991), 63-80.

<sup>36</sup> For instance, see Bhupinder S. Chimni, *International Institutions Today: An Imperial Global State in Making*, 15 *European Journal of International Law* (2004). Ian Hurd, *Myths of Membership: The Politics of Legitimation in UN Security Council Reform*, 14 *Global Governance* (Apr.-June 2008), p.199.

<sup>37</sup> For e.g., see Anja Lindroos & Michael Mehling, *Dispelling the Chimera of 'Self-Contained Regimes' International Law and the WTO*, 16 *European Journal of International Law*, no.5 (2006), 857-877.

international trade, with 97%<sup>38</sup> of world trade being conducted under its aegis, would provide a useful source of coordination of microtrade with other kinds of trade through mutual interaction and negotiation. Decisions over issues like quantitative quotas, extent of SPS requirements, reciprocity or the absence of it, the kind of affirmative measures to be adopted for LDCs etc. in case of microtrade cannot be effectively taken without consideration of the practices and rules being followed in other kinds of trades. It would also provide a ready forum in form of the Ministerial Conference and the General council for conducting discussions over introducing microtrade within the WTO.

A new microtrade regime would require a set of rules, bureaucratic machinery, decision making body and committees for monitoring and review of the working of the new regime. In other words, it would require a whole new institutional and bureaucratic set up at the international level. The WTO which was established in 1994, but was operating since 1947 as GATT; has developed into a repository of important trade related knowledge, specialization, network and bureaucratic machinery. This setup can prove to be of immense assistance to the new microtrade framework. It would save the initial establishment costs for setting up new organizational machinery and would also cause minimum amount of delay in starting with international microtrade. It has been proposed that a Trade and Development Council, with mandate over all development related issues, be established under the WTO.<sup>39</sup> Under this council, a specialized committee on microtrade should also be established. It being a new area of trade needs focused attention in conceptualizing both legal and organizational framework for its functioning.

## 2. Major functions of the council and the committee:

### a. Research

The preliminary task which needs to be performed is to undertake detailed research on various aspects of the future microtrade regime. Some of the broad themes which need research are building a specific legal framework including the necessary amendments to the GATT Treaty and preparing a separate agreement on microtrade; planning of a viable ground mechanism including identifying the bodies with which to coordinate details like supply, storage and transportation of goods; through empirical research and coordination with other organizations, prepare a detailed list of products which can be traded under microtrade and support research on value addition or alteration of those products to make them

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<sup>38</sup> THE WTO IN BRIEF: PART 2, The organization, available at: [http://www.wto.org/english/thewto\\_e/whatis\\_e/inbrief\\_e/inbr02\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr02_e.htm).

<sup>39</sup> *Supra* note 3, at 24

suit the market demand. For carrying on this research, a research center, solely committed to microtrade related research should be established.

b. Network

Numerous other organizations and bodies are also working towards the larger goal of poverty alleviation. A coordinated effort with these bodies, especially with those related to trade, is absolutely essential for achieving an effect akin to the constructive interference of waves. The microtrade committee needs to specifically concentrate on building up mutual dependence within this vast and variegated network working for a common goal.

Three kinds of pre-existing organizations, classified on basis of the core tasks performed by them would serve to provide essential ground network for microtrade. First, research organizations and bodies providing financial assistance like International Finance Corporation at the international level, and other regional and local level organizations which work towards developing strategies for the economic development of less developed parts of the world. Second, Organizations like NGOs and IGOs giving shape to these grand strategies by carrying on specific work at grass root level. For the purposes of microtrade, the most pertinent kind of NGOs would be the ones working to encourage self-employment through small scale labor intensive production of goods, also referred to as cottage industry; and imparting the requisite basic and skilled gradation trainings. Third, those voluntary organizations and the national government initiatives which assist these producers with raw material supply, distribution, transportation, and retail sale of their products.

Thus, a vast network on which microtrade can be built already exists. What is needed is an efficient tapping of the combined potential of the individual components of this network and a cardinal point of connection which would efficiently link these nodes. In addition to the support available in the form of these organizations, there would be a need of a specialized work force for accomplishing the aspects of microtrade which would not be covered by the existing organizational and institutional machinery.

c. Review

Since the proposed regime of microtrade would be a novel experiment in the field of international trade, in the initial years of its operation, it would be extremely important to constantly monitor every stage of its functioning and through a juxtaposition of these individual observances, determine whether the underlying purpose behind conceptualization of this form of trade is being fulfilled well. Lacunae in its working are bound to occur, especially during the starting years of

its operation. Thus, there would be a recurrent need to eliminate those lacunae through introduction of innovative techniques and methods. Along with carrying on these reviews on the overall working of microtrade, individual country reviews would also be needed. The group of LDCs which form the center of microtrade is not homogeneous in composition. There are vast differences between these countries based on geographical location, availability of natural resources, and political structure. By conducting a careful scrutiny of these country reviews, specific problems, which are endemic to a region could be identified and the requisite reformatory steps taken to accost them. This mechanism provides for a well-balanced two pronged approach, top-down and bottom-up.

## **B. Regulatory framework**

As observed in part I, for a microtrade regime to have the intended impact on improving economic status of LDCs, a balance between international and national regulatory framework is important. An international regulatory framework under the auspices of WTO would provide the necessary statutory guidance to the working of international microtrade. The existing WTO law and organization already contain provisions and organs specifically dedicated to facilitate development through trade in the less developed member states. But, these existing provisions and organs need to be streamlined and new provisions and organs introduced to create a microtrade specific regulatory and organizational structure within the WTO. Some of the significant regulatory elements are discussed below.

### **1. Preamble**

Part IV of the GATT 1947, meaningfully titled ‘Trade and Development’ contains provisions which would have preambular significance for the new microtrade system. The principles and objectives mentioned under this part echo the fundamental purposes for which international microtrade was envisaged. It explicitly acknowledges that one of the basic objectives of GATT is “raising the standards of living and the progressive development of the economies,”<sup>40</sup> with particular urgency for “less-developed contracting parties.”<sup>41</sup> It acknowledges the wide gap between “standards of living in the less-developed countries and in other countries”<sup>42</sup> and recognizing the importance of “export earnings”<sup>43</sup> and

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<sup>40</sup> Art. XXXVI(a) Principles and Objectives, Part IV, GATT 1947

<sup>41</sup> Art. XXXVI(b) Principles and Objectives, Part IV, GATT 1947

<sup>42</sup> Art. XXXVI(c) Principles and Objectives, Part IV, GATT 1947

“international trade as a means of achieving economic and social advancement,”<sup>44</sup> exhorts the contracting parties to “use special measures to promote”<sup>45</sup> trade and development in case of the less developed contracting parties. These objectives would guide other components of the regulatory framework.

## 2. Agreement on Microtrade

A whole set of rules would be required to regulate the working of microtrade. A separate agreement under the WTO would be appropriate for laying down the set of rules dealing with all the major regulatory aspects of microtrade. This agreement should be characterized by its mandatory application to all WTO contracting parties. It should comprehensively provide the general rules governing microtrade, organizational set up to be established, functions of different organs and mechanism for dispute resolution. Some of the general rules of microtrade would be: granting of special status to products traded under microtrade; mandatorily requiring the importers of these products to amend their national laws within a specified time limit, for permitting their duty free import, up to the quantitative quota limit determined by this agreement and; not requiring the least developed countries to reciprocate these concessions by way of the general principles of WTO like Most Favored Nation Treatment (MFN) and National Treatment (NT). The agreement would also sketch out the organizational set up required for microtrade. The research body described above, the proposed Council on Trade and Development, and a committee on microtrade would act as the major nodal points for regulation of microtrade. These would act as the focal points of contact both with extra WTO organizations and other WTO organs. In case of disputes arising in context of microtrade, there should be special rules for dispute resolution.

Due to the nature of trade and the parties involved, requisite amendments need to be made in the WTO Dispute Settlement Undertaking.<sup>46</sup> It should be ensured that the costs for taking the dispute to WTO are not prohibitory for the LDC(s) involved in the dispute. Arrangements should be made for free legal advice and representation. There should be a specific time limit for dispute resolution in the case of disputes relating to microtrade. Disputes involving microtrade should be mandatorily given priority for faster resolution under the DSU. The DSU should be amended to accommodate these specific microtrade related requirements.

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<sup>43</sup> Art. XXXVI(b) Principles and Objectives, Part IV, GATT 1947

<sup>44</sup> Art. XXXVI(e) Principles and Objectives, Part IV, GATT 1947

<sup>45</sup> Art. XXXVI(f) Principles and Objectives, Part IV, GATT 1947

<sup>46</sup> Understanding on rules and Procedures Governing the Settlement of Disputes, Annex 2, WTO Agreement.

Apart from these amendments, there is also a need for considering the proposals arising from the third world, for amendment of dispute resolution mechanism under WTO. Time and again, dissatisfaction with different aspects of WTO DSU has been expressed. Some of the most recurring points of dissatisfaction are its “resource-demanding”<sup>47</sup> nature, the rules on remedies which have been unfairly structured to favor developed countries and the inadequacy of substantive rules in delivering justice to the developing countries.<sup>48</sup> A case in point is the ‘collective retaliation’<sup>49</sup> mechanism, proposed by the African Group,<sup>50</sup> in order to make trade dispute remedy more equitable by giving developing parties a de facto power to counter the economic might of the developed party to the dispute.

Amendment of the WTO DSU on both of these lines- specific and general- would provide a substantial backing to the successful operation of the microtrade regime. Along with these substantive amendments in the WTO texts, there is also a need for adoption of a development objective oriented purposive interpretation of the WTO agreements by the DSU.<sup>51</sup>

### 3. Microtrade and microfinance: linkages and lessons

The two terms, Microfinance and Microtrade have much more in common than merely the prefix, ‘micro.’ At the macro level, both form an integral part of the worldwide efforts at poverty alleviation through economic empowerment of people inhabiting less developed parts of the world. They stand to share a symbiotic relation because when acting singly, each one’s poverty fighting capacity is limited. Those small producers and traders who will participate in microtrade would need credit as one of the most important inputs to undertake production and trade. On the other hand, microfinance would be effective only if

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<sup>47</sup> See Gregory Shaffer, *How to Make the WTO Dispute Settlement System Work for Developing Countries: Some Proactive Developing Country Strategies*, ICSTD Resource Paper No. 5 (March 2003).

<sup>48</sup> *Ibid.*, p. 14.

<sup>49</sup> Sayera J. Iqbal Qasim, *Collective Action in the WTO: A “Developing” Movement towards Free Trade*, 39 U. Mem. L. Rev. 175 (2009). Brendan P. McGivern, *Seeking Compliance with WTO Rulings: Theory, Practice and Alternatives Symposium: Terrorism’s Burdens on Globalization*, 36 International Law (2002), 141.

<sup>50</sup> See WTO, *Negotiations on the Dispute Settlement Understanding- Proposal by the African Group*, WTO Doc. TN/DS/W/15 (25 September 2002).

<sup>51</sup> See generally, Asif Qureshi, *Interpreting WTO Agreements for the Development Objective*, ICSTD Resource Paper No. 5 (March 2003).

the credit taken is used to conduct a sustainable income generating activity as opposed to spending the loan money on mere consumption.<sup>52</sup>

At the more intricate level too, there are multiple zones of overlap between the two concepts. Both of them have been conceived to work for a common objective, following a grass root level based approach. The economy at this micro level is usually concentrated in the so called 'informal' sectors which have been left out of state regulation. Both of these innovations are conceived as bottom-up approaches but are sought to be applied globally, thus, they need a balance between the domestic and the international regulation.

The idea of microfinance, as a devise to fight poverty was conceived a few decades back. Since then, it has been implemented in most credit starved developing parts of the world. As a concept, it has evolved over a number of years since its inception. Over time, various lacunae have appeared in working of microfinance in many of the regions where it has been implemented. Microtrade on the other hand is a novel conception and is yet to be implemented. The close linkage between these two innovations, renders the experience undergone by the microfinance sector and the lessons learnt thereupon, very significant for the yet to be established microtrade regime. This paper undertakes a case study of the recent microfinance related crisis, experienced in the Indian state of Andhra Pradesh.

### **C. Microfinance: source of credit**

One of the most crucial requirements for sustainably maintaining the microtrade regime described above is timely and accessible financing facilities for the producers and traders of goods meant for microtrade. The microtrade regime is meant to bring about poverty alleviation and development of small producers of goods, mainly from developing and LDCs through opening up trade opportunities in their countries as well as abroad. The current statistics on financial inclusion for such producers or potential producers show that most of them are subjected to various degrees of poverty and typically fall outside the reach of formal financial system.<sup>53</sup>

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<sup>52</sup> See Vijay Mahajan, "From Microcredit to Livelihood Finance," in Thomas Dichter and Malcolm Harper (eds.), *What's Wrong with Microfinance?* (London: Practical Action Publishers, 2007), p. 241.

<sup>53</sup> It is not the case that absolutely no means of finance are available. Usually some kind of informal means of finance like local money lenders, chit funds and credit giving groups like *bishis* in South Western India. In many developing countries, formal financial institutions like banks have made considerable inroads amongst the low-income population. But, most of these means have proved to be grossly inadequate to meet credit and other financial needs of people. Both

As an alternative to the traditional informal sources of financing, microfinance was developed as an effective tool of poverty alleviation for billions of people the world over. Among other facilities like insurance, savings etc., micro-credit is considered to be the most significant aspect of microfinance. It was originally envisaged as a group based credit system, where credit was provided to a group of women and the group as a whole was responsible for repayment of the loan taken by individual group members.<sup>54</sup> Today, microfinance as an idea and a tool for development has reached most of the developing parts of the world right from Africa to South America to Asia, and it is on course to further deepen its influence in these regions. This is apparent from the fact that the NGOs are no more the sole microfinance service providers and there is a considerable proliferation of non-bank microfinance institutions (MFIs). The potential of microfinance for assisting in attaining the Millennium Development Goal (MDG) of poverty alleviation has evinced interest at the domestic, regional, and international level. The United Nations Commission on International Trade Law (UNCITRAL) in its forty-second session recognized the need to study the microfinance sector in the context of international economic development, for gauging the need for developing a “regulatory and legal framework aimed at protecting and developing microfinance sector... with a view to assisting legislators and policymakers around the world.”<sup>55</sup>

#### **D. Microfinance: more than mere credit**

Microfinance, due to its multiple advantages can serve to form one of the fundamental elements in promoting microtrade.<sup>56</sup> First, the concept of microfinance is specifically structured to meet the requirements of low income groups. Credit is available for a variety of purposes like for consumption purposes

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these means of finance suffer from various limitations. In case of the former, usurious interest rates; deployment of coercive means for loan and interest recovery; availability of small loan amount which are usually adequate to meet consumption needs only and thus are inadequate to establish or expand a business; and very short duration installment payback periods comprise of four major concerns. In case of the latter, limited reach especially amongst the rural populace; need of collateral; cumbersome procedures and difficulty to obtain medium sized loans pose major hurdles in accessibility of low income groups to financial facilities.

<sup>54</sup> What is Microcredit? Grameen Bank (October, 2011), available at:

<[http://www.grameen-info.org/index.php?option=com\\_content&task=view&id=28&Itemid=108](http://www.grameen-info.org/index.php?option=com_content&task=view&id=28&Itemid=108)>.

<sup>55</sup> UN Report of UNCITRAL, 42<sup>nd</sup> session (29June-17 July 2009); General Assembly, Official Records, Sixty-Fourth Session, Supplement No. 17

<sup>56</sup> For understanding the difference between microfinance and microcredit, see Khandakar Qudrat-I Elahi and M. Lutfor Rahman, *Micro-Credit and Micro-Finance: Functional and Conceptual Differences*, 16 *Development in Practice*, no.5 (2006), 476-483.

to business investment to agricultural inputs. Second, by doing away with the requirement of collateral as a condition for giving credit, microfinance has removed the biggest impediment in accessing credit for people living under poverty. Instead of pledging collateral or a demand for an initial deposit, novel techniques like group responsibility and peer pressure are deployed for credit recovery. Third, apart from credit, additional features like cash deposits and insurance facilities also form an important part of microfinance.<sup>57</sup> This serves to spread financial literacy amongst the low income people, who by using these products stand to benefit considerably, by enhancing their income and resources through deposit facility and avail insurance in case of contingencies.

By availing the wide range of microfinance products, artisans, farmers and traders involved in microtrade, stand to benefit considerably in starting a business or trade, procuring raw materials and expanding the business. Microfinance products, specifically oriented towards microtrade would provide a great impetus towards its development. Such a step has been taken by the launch of the European Solidarity Financial Fund for Africa (FEFISOL), Africa's first specialist microfinance fund for supporting small farmers conducting organic farming and helping these organic products gain access to the existing fair trade markets and exploring the possibilities of opening other such markets.<sup>58</sup>

### **E. Microfinance: emerging challenges**

But, recent developments in the microfinance sector in certain parts of the world show that it is moving towards an unsustainable trajectory and has led to questioning of the perception of its near panacea quality in poverty alleviation. It is surprising that in spite of such rapid growth and popularity, this sector is largely unregulated. Though microfinance related problems have surfaced in many regions of the world, this paper deals with the crisis in the Indian microfinance sector. The rapid spread of microfinance in India, making available finance

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<sup>57</sup> For an overview of additional facilities like deposit-taking, insurance etc. provided under microfinance, see Colin Kirkpatrick et al, *The Implications of the Evolving Microfinance Agenda for Regulatory and Supervisory Policy*, 20 Development Policy Review, no.3 (2002), 293-304. C.F. Churchill, *Making insurance work for microfinance institutions: A Technical Guide to Developing and Delivering Microinsurance* (2003). B Balkenhol and Craig Churchill, "From Microfinance to Micro Health Insurance", in David M. Dror and Alexander S. Preker (eds.), *Social Reinsurance: A New Approach to Sustainable Community* (2002) pp. 75-100.

<sup>58</sup> Press Release, *Africa's First Microfinance Fund for Sustainable Farmer's Launched*, BEI/11/116 (July 21, 2010), available at: <[http://www.cgap.org/gm/document-1.9.52410/FEFISOL\\_communiq%C3%A9-EN-21-07-2011.pdf](http://www.cgap.org/gm/document-1.9.52410/FEFISOL_communiq%C3%A9-EN-21-07-2011.pdf)>.

facilities to millions of low income households, held great promises as being a pioneer in large scale poverty alleviation. But, the growth story of microfinance has been marred by certain alarming developments which are bound to have repercussions on other parts of the world as well.<sup>59</sup> The Indian experience serves to highlight some major problems under the current microfinance regime. This experience is relevant not only in the Indian context; rather it has wide ramifications and thus is pertinent for the development of the microfinance sector in other developing parts of the world as well. There is a considerable similarity in the models of microfinance being implemented in different countries. Although, region specific variations in the problems being faced by this sector are bound to exist, there are certain generic challenges confronting this sector everywhere.

1. Case study: andhra pradesh experience

a. Course of events: ball set rolling in 2006

Symptoms of the current microfinance related crisis in Andhra Pradesh first appeared in 2005-06. In 2006, the local government in the Krishna district of the State of Andhra Pradesh ordered the shutdown of most microfinance institutions (MFIs) due to numerous complaints relating to strong-arm tactics used by recovery agents employed by MFIs, usurious interest rates and non-transparency relating to final interest rates chargeable. The shutdown orders were revoked only after Sa-Dhan (The Association of Community Development Finance Institutions) adopted a voluntary mutual code of conduct for MFIs.<sup>60</sup> The code of conduct enumerated certain core values like transparency, fair practices and integration of social values into operations and feedback mechanism to be followed by the MFIs; a code of conduct based on these core values; and a detailed compliance mechanism including an 'Ethics and grievance Redressal Committee,' to facilitate MFI's compliance with the code.

But, the limitations of these voluntary guidelines soon became apparent as public distress continued in the State. A slew of suicides committed due to the inability of borrowers to pay back loans taken from MFIs show that microfinance related distress has worsened. The gender dynamics are visible in this field as

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<sup>59</sup> For e.g., see Jonathan Morduch, *The Microfinance Schism*, 28 *World Development*, no.4 (2000). Rodolphe Blavy et al. (eds.), *Microfinance in Africa: Experiences and Lessons from Selected African Countries* (2004). Jude L. Fernando, *Microfinance: Perils and Prospects* (Routledge Studies in Development Economics, 2006). Marguerite Berger et al (eds.), *An Inside View of Latin American Microfinance* (2006). Cosmin Olteanu, *Overindebtedness in Microfinance: Case-study of the Clientele of Financiera CREAM, Los Olivos, Lima Norte, Peru* (2011).

<sup>60</sup> Sa-Dhan, *Core Values and Mutual Code of Conduct for Micro Finance Institutions*, available at: <[http://www.sksindia.com/downloads/sa\\_dhan\\_core\\_values.pdf](http://www.sksindia.com/downloads/sa_dhan_core_values.pdf)>.

well. The primary customers of Microfinance products are women belonging to low income households. In Andhra Pradesh, more than eight million women from economically poor strata have been organized into different self-help groups (SHGs).<sup>61</sup> These SHGs are the primary clients of MFIs and instead of individual liability the group as a whole becomes liable for non-payment of debt. Therefore, women forming majority of the MFI's clientele, have come to be disproportionately affected by Microfinance related problems. Due to gravity of situation, the governor of Andhra Pradesh in October 2010 promulgated an ordinance "to protect women Self Help Groups from exploitation by the Micro Finance Institutions..."

The Ordinance in its Statement of Object and Reasons clearly mentions that the purpose underlying that the ordinance was enacted in the larger public interest to protect the poor from exploitation and to regulate lending of monies by SHGs.<sup>62</sup> In light of these objectives, the ordinance provided the following three major steps towards regulation of microfinance in the State: 1) it mandated compulsory registration of MFIs; 2) it specified the 'maximum amount of interest recoverable on loans and discharge of loans in certain cases'; and 3) it provided for the establishment of a fast track court for the settlement of disputes in every district of the State. This ordinance has not been very well received by MFIs in the State as the regulations imposed by it have made it difficult for these institutions to sustain themselves profitably.<sup>63</sup> These series of events lead one to analyze how things went wrong with an innovation which was heralded as having panacea like quality for alleviating large scale poverty from the face of the globe.

## 2. An analysis of causes behind the microfinance crisis

### a. Purpose: welfare vs. profit motive

The innovations in designing finance services for low-income people were originally aimed at the objectives of enabling this group of population to step out of poverty by undertaking productive activities; and diminish economic, social and gender inequalities by encouraging a social business model to be followed. For instance, the Grameen Bank of Bangladesh was established in 1976 with the

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<sup>61</sup> See Vijay Kumar Thallam, "How can Organizations of the Poorest Best be Fostered?" in Joachim von Baun et al (eds.), *The Poorest and Hungry- Assessment, Analyses and Action* (Washington D.C: International Food Policy Research Institute, 2009) p. 465, available at: <<http://www.ifpri.org/sites/default/files/publications/oc63essay05.pdf>>.

<sup>62</sup> Statement of Objects and Reasons, An Ordinance to Protect the Women Self Help Groups from Exploitation by MFIs in the State of Andhra Pradesh and for Matters Connecting Therewith, 2010.

<sup>63</sup> For e.g., Tamal Bandyopadhyay and Dinesh Unnikrishnan, *India's oldest microfinance firm on the verge of closure*, in The livemint.com, The Wall Street Journal (27 July 2011), available at: <<http://www.livemint.com/2011/07/27003826/India8217s-oldest-microfina.html>>.

objectives of creating self-employment opportunities for rural poor and “to reverse the age-old vicious circle of "low income, low saving & low investment", into virtuous circle of "low income, injection of credit, investment, more income, more savings, more investment, more income.”<sup>64</sup> Even the loan products catering to lifecycle needs like housing, offered by the Grameen Bank of Bangladesh, in light of the social objective of promoting gender equality mandatorily requires the title deed of the land to have name of the woman who avails the loan.<sup>65</sup>

When a product which is specifically designed with a social purpose is primarily used for profit purposes, problems are bound to occur. Though with appropriate modifications, a double bottom line of social and private profit can be attained, but it is not always possible and an unambiguous choice of the primary motive has to be made.<sup>66</sup> A preliminary analysis of the role of Indian law firms in microfinance sector shows that a large part of their role comprises of converting for non-profit microfinance organizations to for-profit organizations.<sup>67</sup> Such a phenomenon is bound to have far reaching ramifications in a State like Andhra Pradesh, where as early as 2005, approximately 92% of poor households were covered under SHGs. Most of the MFIs which are the primary source of finance for the SHGs in the State initially started as non-profit oriented entities but subsequently became profit oriented, resulting in lowering of customer care standards.<sup>68</sup>

“The need to determine that the primary purpose is a social purpose, rather than profit-oriented purpose, is important because each purpose requires a different mindset. A profit oriented service which provides finance to the lowest income strata of the population would necessarily focus on profits in the form of interests rates and credit worthiness while the larger goal of global poverty eradication would have to consider many other measures; for example, subsidies

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<sup>64</sup> See *A Short History of Grameen Bank*, Grameen Bank- Bank for the Poor, available at:

<[http://www.grameen-info.org/index.php?option=com\\_content&task=view&id=19&Itemid=114](http://www.grameen-info.org/index.php?option=com_content&task=view&id=19&Itemid=114)>.

<sup>65</sup> Mohamad Yunus, *Creating a World Without Poverty: Social Business and the Future of Capitalism, Transforming Urban Markets for the Poor through Collaborative Entrepreneurship*, 4 Global Urban Development Magazine, no.2 (2008), p. 77.

<sup>66</sup> See Prabhu Ghate, *Indian MicroFinance: The Challenges of Rapid Growth* (Sage Publications, 2007).

<sup>67</sup> See Elisabeth Rhyne, *Microfinance: Keeping the Mission When Non-Profits Become For-Profits*, ACCION's Center for Financial Inclusion, for the Huffington Post, available at:

<<http://www.accion.org/page.aspx?pid=2084>>;

Bar&Bench News Network, *Microfinance: Booming segment interests lawyers and law firms?* (Mar 30, 2010), available at:

<<http://barandbench.com/brief/2/617/microfinance-booming-segment-interests-lawyers-and-law-firms>>.

<sup>68</sup> See *Microfinance Africa, Yunus advocates regulatory body for micro credit in India* (December 18, 2010), available at:

<<http://microfinanceafrica.net/tag/microfinance-regulation-in-india/page/2/>>.

to create employment training programs and social distribution channels.” The social and economic welfare potential of microfinance has been acknowledged by most domestic legislations and even by the reports and guidelines prepared by international organizations like UNCITRAL and CGAP. An explicit acknowledgement of the objective of a MFI would serve to minimize the obfuscation caused amongst its clients. The clients would have the clarity and information as to decide whether their particular requirement is obtaining credit regardless of interest rate or vice versa.

b. Competition between MFIs; non-disclosure of interest rates and financial illiteracy

A consequence of the movement of MFIs towards profit motive is the competition between different MFIs operating in the same region. Each MFI operating for profit aims to increase its customer base and the disbursed loan amount. The push for increasing the number of customers is understandable, given the very small average loan size. The agents employed by MFIs to disburse loans are paid as per the number of customers they can rope in. This acts as an incentive for them to disburse loans quickly, without properly explaining the terms and conditions to their customers. This is especially so with regard to interest rates as microfinance interest rates on an average are pretty high as compared to conventional loans from banks. Usually there are conditions requiring frequent periodic payment of installments like on a weekly or monthly basis. Failure to pay an installment usually leads to application of a higher penalty interest to rest of the loan.

The situation is compounded by their general illiteracy accompanied by financial illiteracy of most of the customer base of MFIs. This makes them easy prey to glib dealings by MFI agents and creates a cycle of credit, which makes it difficult for customers to repay their loans. Customers are at times coaxed into taking multiple loans, whose periodic repayment becomes difficult and often due to compounding interest as a penalty for failure to pay, they are forced to take fresh loans to pay back previous loans. In order to prevent financial losses due to failure of customers to pay back loans, the MFIs often resort to using high handed techniques through their recovery agents.

c. High transaction costs

The very nature of microfinance makes it a costly activity to carry on profitably. Due to widely disbursed, small number of loans, for low amounts in remote regions where usual banking does not operate, makes the transaction costs of providing microcredit very high. The transaction cost mounts up due to most of

the customers residing in remote areas, hiring agents to reach the customers, recovering the loaned amount on a periodic basis in very small amounts etc.

The average interest rate in case of micro-credit is around 35%, which is very high as compared to a bank loan which is about 10%.<sup>69</sup> The micro-credit loans are often termed usurious due to such high percentage. But, often in reality the transaction costs are so high for microlenders, that to run profitably, or even at a break-even point, the interest rates would have to be higher than average.<sup>70</sup>

d. No provision for monitoring how the loaned amount is used

The general customer base of MFIs is comprised of economically weaker sections of population. They often need small amounts of credit for consumption purposes. Many times, a loan taken in name of a commercial activity is used over social expenditure like a marriage or over day-to-day consumption needs. It has been observed in Andhra Pradesh that easy availability of micro-credit from multiple MFIs has led to a remarkable increase in alcohol consumption amongst the male members of the community.<sup>71</sup> Thus, absence of the monitoring for which the loaned amount is being spent is a serious cause for worry. This also points towards the need for non-profit/government sponsored organizations and schemes to train the low income groups in different ways of income generating activities.

These problems made the government of Andhra Pradesh pass an ordinance with immediate effect in 2010 primarily aimed at protecting “the Women Self Help Groups from Exploitation by the Micro Finance Institutions.”<sup>72</sup> But, considering the scale of problem and the possibility of its ramifications reaching other parts of the country as well, the Indian government has proposed a bill,<sup>73</sup> regulating microfinance all over India. Some of these problems are endemic to the state being studied (examined, discussed, etc.) but many are being faced in other parts of the world as well.<sup>74</sup> In the case of countries where national laws are not effective, international regulation of microfinance is important.

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<sup>69</sup> For an overview of microfinance interest rates in different countries, see Richard Rosenberg, Why do microcredit interest rates vary so dramatically around the world?, CGAP Microfinance Blog (June 20, 2008), available at: <<http://microfinance.cgap.org/2008/06/20/why-do-microcredit-interest-rates-vary-so-dramatically-around-the-world/>>

<sup>70</sup> Beatriz Armendariz and Jonathan Morduch, *The Economics of Microfinance* (Cambridge: Massachusetts Institute of Technology Press, 2010), p. 8.

<sup>71</sup> See *MFIs lay small-debt trap in Andhra*, Inforchange micro-credit (November 24, 2011), available at: <<http://infochangeindia.org/micro-credit/news/mfis-lay-small-debt-trap-in-andhra.html>>.

<sup>72</sup> An Ordinance to Protect the Women Self Help Groups from Exploitation by MFIs in the State of Andhra Pradesh and for Matters Connecting Therewith, 2010.

<sup>73</sup> The Microfinance Institutions (Development and Regulation) Bill, 2011.

<sup>74</sup> see CGAP, *Andhra Pradesh 2010: Global Implications of the Crisis in Indian Microfinance*, available at: <<http://www.cgap.org/gm/document-1.9.48945/FN67.pdf>>.

#### IV. CONCLUDING REMARKS

A similarity of purpose, scale and the regions of operation of the existing microfinance regime and the proposed microtrade regime make the challenges confronting the microfinance sector relevant for the microtrade sector as well. Thus, a cue needs to be taken from the microfinance experience, in order to avoid similar pitfalls in the microtrade regime. Some of the observations for the proposed microtrade regime are:

The welfare motive behind microtrade should be abundantly clarified and reinforced time and again so as not to experience the dichotomy between social and profit orientations and the consequent problems being faced by the microfinance sector. A mechanism developed for dealing with acute poverty is not always easily convertible into a profit making scheme without causing an immense loss to the very purpose of such a mechanism.

In order to prevent exploitation at the hands of middlemen, of those for whom the benefit is envisaged, appropriate regulation at both the national and international level, needs to be put in place. This is especially true for private players primarily driven by a profit making motive.

There is a need for constant review of whether the fundamental purpose behind these mechanisms is being fulfilled as per the expectations. Need for region specific variations depending upon endemic circumstances should be studied and the requisite variations incorporated in order not to superimpose a locally unsuitable model of development. The policy decisions relating to developmental devices like microtrade and microfinance should be taken, keeping in mind the complementarities between them, in terms of attaining maximum developmental benefits for the targeted region and population.

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