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Moneylending or financial service: the politics of regulating microfinance in India

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ABSTRACT

The Andhra Crisis of 2010 is well known as a critical juncture for microfinance as borrowers were coerced and reportedly committed suicide due to repayment pressures. This presented a regulatory challenge to the Indian state: was microfinance 'moneylending' or 'financial services' and how was it to be regulated? Scholarship on state capitalism highlights new responsibilities taken on by states by participating in financial markets. In contrast, postcolonial studies show how the neoliberal postcolonial state actively hands over key responsibilities to private actors. By bringing in the concept (and practices) of the developmental state, I show how multiple levels of state authority present both neoliberal and developmental approaches to state-finance relations. Drawing on multi-scalar fieldwork with central and state institutions in India, this paper highlights central institutions' neoliberal logics for classifying microfinance as a 'financial service' contra state-level institutions' developmental prescription to classify it as 'moneylending'. Ultimately, the regulatory challenge is resolved by instating self-regulation for the sector. This shows how despite contestations, financial services that target low-income groups can reshape state authority, regulation and accountability and align these with market logics.

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Introduction: the Andhra Crisis and the rightful regulator for microfinance

Following the 2010 Andhra Microfinance crisis, in which reportedly over 200 borrowers committed suicide as they faced increased pressures from microfinance institutions (MFIs) to repay loans and were trapped in debt, former Reserve Bank of India governor, Y. V. Reddy (2011) voiced his critical position on the microfinance sector and the need for a closer assessment of the business by saying,

> If it is profit and there is lending, aggressively, then it's just moneylending. Profit-seeking MFIs should be studied as they do not come under the laws relating to moneylending or usury. After all, they do no better than moneylenders.

This was not just a moral exhortation to circumscribe microfinance as moneylending, but rather a question of legal and regulatory categorisation. As former governor of the Reserve Bank of India (RBI), the country's central bank, Reddy was a prominent financial voice in the country at the time. He held the reputation of being a key figure in shielding the Indian economy from the 2008 financial crisis by controlling economic risk and adopting stronger regulatory oversight (Reddy 2010, Dutt 2013). His statement above surfaces the challenge facing Indian state authorities following the Andhra Crisis: how to define and regulate microfinance? Who is to be denominated as the

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rightful regulator for microfinance? What are the objectives of regulation? Different levels of state authority presented diverging answers to these questions, spanning neoliberal and developmental logics for prescribing state-finance relations and these contestations extended over several years. The matter was eventually settled by conceiving a form of regulation which was new to India – financial self-regulation. Microfinance was eventually rescheduled from 'moneylending' to a 'financial service' as neoliberal state approaches trumped developmental positions.

The Andhra Crisis of 2010 had been a direct result of increased financialisation of the micro-lending sector. As the repayment rates of Indian micro-loans were consistently high, this attracted financial investments into Indian microfinance institutions (MFIs). This incentivised Indian MFIs to maximise numbers of loans and ensure higher returns and interest payments for their investors. In this financialisation process, 'profits accrue primarily through financial channels' (Krippner 2005) and underbanked, low-income women are enfolded into global circuits of finance. Micro-loans were further securitised in which multiple loans were pooled together into a portfolio and turned into a 'security' which can be traded and sold to investors (Bogan 2011). An investor who owns such a security is then entitled to the loan principal and interest collections. As this happened, micro-lending transformed from a previously developmental, non-profit activity to a highly financialised, profit-maximising sector. Similar to credit-related financial crises in other contexts, MFIs did not conduct proper due diligence when extending credit and ended up coercing women to repay even when they were unable to do so (Palmer 2013). As borrowers were negatively impacted, state authorities were forced to grapple with the question of defining and regulating microfinance. This paper shows that the process of answering this question of regulating microfinance ends up significantly reshaping Indian state authority and exercise of power. In this transformation, state institutions are active agents that hand over key responsibilities to private finance.

The challenge of defining how to regulate microfinance was met with multiple, varied responses from different levels of state authority. In India's federal model, the regulation of credit provision has been decided through power distribution set out in the national Constitution. The Constitution allocates power between the central (Union) and State[1] governments through three lists – the Union List, which enlists subjects on which the Parliament of Indian legislates, the State List, which includes subjects on which state legislative assemblies legislate and finally, the Concurrent List, which contains issue areas that fall under the joint domain of Union and state governments (Jagannadham 1947). The constitutional logic behind categorising issues across different governmental levels historically hinged on discerning whether the issue is deemed as requiring localised, region-specific knowledge, suited to regionally differentiated contexts and histories (Haqqi 1961, Sonwani 2016). For instance, agriculture was placed on the State List given India's varied agro-climatic zones, cropping patterns and social arrangements. In a similar vein, and in light of India's colonial history of varied subjugation to differing debt regimes under the British, moneylending was also made a State List issue.

Following the Andhra Crisis, central state authorities sided with financial institutions in arguing for microfinance to be classified as a 'financial service' and instead of being regulated by central state institutions, be made self-regulated. On the other hand, state governments construed microfinance as moneylending and subsequently as a sector to be strongly supervised by regional authorities in order to protect borrowers from potentially predatory lending practices. In doing so, central authorities propounded neoliberal logics, here understood as 'belief in the self-regulating properties of the market' and in arguing for credit as a necessary feature of life (Konings 2016). In contrast, state-level authorities took a protectionist, developmental approach in which the state intervenes in relation to private finance to achieve economic goals alongside equity. Ultimately, these contestations were resolved by moving regulation to newly instated self-regulatory organisations (SROs). The RBI designated MFIN and Sa-Dhan, two networks of MFIs, as SROs in 2014 (RBI 2014). SROs soon became a norm in regulating finance in India, extending to securities markets, banking and mutual funds (SEBI 2019, 2023). Hence, the regulation of what Ananya Roy (2016) has labelled as 'poverty capital', which is capital that seeks accumulation by investing into the poor, ends up shaping wider state-finance relations and regulatory architecture.

I show that increased financial capital encounters multi-scalar contestations and ultimately reshapes state authority. In these transformations, state actors and institutions are active agents that strategically hand over regulatory and credit provision responsibility to private finance. This shows that financial services (such as microfinance) that target low-income groups and particularly women, significantly reshape state authority, regulation and accountability.

India is the largest market for microfinance today with more than 130 million active micro-loans in 2023 (MFIN 2023). Despite critical research that has shown the inadequacies of Indian microfinance, international organisations often uphold the Indian case as a 'successful' story for the evolution and dispersal of microfinance (Goel and Aggarwal 2020, Milana and Ashta 2020). These cite the key role played by state authorities in creating an appropriate regulatory framework and support mechanisms for enabling sectoral growth (Sriram 2017). As such, the evolution of India's regulatory framework can provide insight into the politics of financial services and its consequences on state authority more broadly. The material used in this paper is particular to the Indian case and grounded in its specific political history with finance and internal distributions of jurisdictional power. These specific sites and processes allow for tracing and examining global processes and how wider trends become manifest and are challenged (Schatz 2009, Aronoff and Kubik 2013).

To engage with state transformations, I follow a multi-scalar approach by combining interviews and document analyses from central and state institutions. With fieldwork conducted over 9 months between July-September 2021 and September 2022-February 2023, this paper is developed with data collected from semi-structured, in-depth interviews with 8 representatives from central institutions including national development banks, key national ministries and the Reserve Bank of India. At the regional level, I interviewed 11 representatives from state-level ministries, rural development staff and regional representatives from MFIs. I collated this data with extensive analysis of primary sources (see: Bibliography) including official reports, press releases, circulars, parliamentary bills and records of judicial proceedings on microfinance. I chronologically organised and coded this data on NViVo so as to analyse different registers of interpreting, classifying and regulating microfinance.

This paper is structured as follows: I first situate this research at the intersection of international political economy (IPE) scholarship on state-finance relations, postcolonial studies of the state and contributions on the developmental state. The section *Financialisation of credit to the underbanked: Regulatory challenge for state authorities* discusses the financialisation of loans with microfinance that resulted in the Andhra Crisis and subsequent regulatory challenges for state authorities. In *Microfinance is moneylending: Developmental state and regulation by oversight*, I discuss the developmental state approach adopted by state governments, followed by two sections that discuss central governments' neoliberal policies that facilitate microfinance and introduce self-regulation as a way to hand over state responsibilities to private finance. Finally, the conclusion reflects on continued contestations and the implications of financial regulation for state authority transformations.

Not only 'micro': microfinance and state transformations

Scholarship in political economy on financialisation has shown that as the financial sector grows within the economy in size and relative importance, it effectively results in retracting role of the state in domains such as infrastructures (Langley 2018), pension funds and social infrastructures (Clark 2000, Toporowski 2002, Wray 2009) and healthcare provision (Branco and Costa 2019). This argument has been similarly put forth in scholarship on microfinance, which financialises credit provision and is accompanied by diminishing role of the state not only in rural credit provision but also in potable water provision (Mader 2014) and extension of social housing (Grubbauer 2019). More recent scholarship however contests these claims of state retraction and highlights that states, including those in the Global South, are active agents that participate in financial markets. This has been discussed as falling under 'state capitalism' defined by Alami *et al.* (2021) as a 'variegated world-historical phenomenon rooted in the historical development and geographical remaking of capitalism' in which states assert their roles more strongly vis-à-vis financial markets and also come to own capital. In relation to development policies, this further involves a transition in the role of the state as a 'promoter, supervisor and owner of capital' (Alami *et al.* 2021). Nölke *et al.* (2019) compare 'state-permeated capitalism' across emerging economies including India, which is categorised as having a hybrid economic model in which state actors remain active in running key industries and shaping market conditions. Indian state capitalism persists as central state institutions own and operate public sector enterprises including in the energy sector (Chatterji 2017) and mining industries (Som 2022). Following the 2008 GFC in particular, states both intervene through forms of 'state-capital hybrids' including state owned enterprises and sovereign wealth funds (Alami and Dixon 2020). In this literature on state capitalism, state relationship to finance capital is defined in terms of new state responsibilities undertaken through participation in finance markets.

Contra this, postcolonial studies and anthropological interventions on state-finance relations highlight that the neoliberal postcolonial state actively shirks responsibility and accountability with increased financial flows. Randeria (2007) terms this as the 'cunning' of the neoliberal Indian state which is both an 'agent and an object of globalization'. These further show that the state is not monolithic and large-scale development programmes can co-exist with neoliberal policies (Gupta and Sharma 2006). Neoliberal policies can translate in regionally variegated ways in India and depend upon 'composition of the local governing coalitions' (Chatterji 2017). Political networks and mobilisations shape state policies in relation to market forces at the micro level, as these are used and resisted by various interest groups (Pattenden 2005). Internally diverse and variegated state responses have been further discussed in scholarship tracing state transformations particularly in India, including Saez (2002) noting how increased economic liberalisation results in inter-jurisdictional competition between regional state governments. Others point that neoliberal policies increasingly centralise economic authority (Patnaik 2018). With the recent COVID pandemic, challenges of crisis management raised questions around why India's state governments face fiscal distress and are exceedingly dependent on central authorities for revenue (Choutagunta *et al*. 2021). This has brought forth reflections on market-based state policies and their consequences for fiscal distributions between central and state governments in India (Chacko 2018, Aiyar and Kapur 2021). When it comes to financial arrangements, the predominant focus of this scholarship on state distribution of power in India has largely been on fiscal dimensions but rarely on financial regulation. This is presumably because financial regulation has been constitutionally designated to be a 'Union List' issue, hence as an issue domain that falls clearly under the ambit of the central government. However, with the Andhra Crisis, the classification of microfinance became a contentious issue, consequently complicating financial regulation and its jurisdiction.

To grapple with the issue of financial regulation, I bridge this scholarship on neoliberal state transformations and internal variegation with literature on the developmental state. Neoliberal state policies co-exist with developmental state agendas. The concept of the developmental state emerged with growing scholarship on the 'East Asian Miracle' which explored why countries such as South Korea and Taiwan experienced high economic growth rates under strong state intervention (Beeson 2004, Kalinowski 2008). This emphasises the importance of state authority in enabling industrialisation and overcoming market failures (Hayashi 2010). In this discussion, India occupied a distinctive place in which the developmental state was characterised by more decentralised forms of governance. As Kohli (2006) highlights, state governments historically play a crucial role in Indian economic planning alongside the central government. The Indian developmental state is shaped by its federal structure which requires balancing between long-term national goals and more short and medium-term local, variegated interests (Jayal 2006). Chatterjee (2008) similarly explains India's particular democratic arrangement of power in which unlike aforementioned East Asian economies that focus on industrialisation through a centralised bureaucracy, the Indian developmental state has to simultaneously ensure that it responds to pressing citizens' demands and local needs for welfare goods.

The challenge of regulating microfinance brings up contesting state claims spanning neoliberal and developmental approaches. In this case, central state authorities contend for neoliberal agendas of financial self-regulation and citizens' entrepreneurial self-management, while state governments argue for protecting citizens' economic needs and addressing immediate grievances alongside more long-term macro-economic planning. These contestations representing neoliberal and developmental state approaches are ultimately addressed by adhering to neoliberal logics and bringing the microfinance sector under self-regulation. In this, challenges of financial regulation with new financial services, result in state transformations which end up reshaping state authority, regulation and accountability to align these with market logics.

Financialisation of credit to the underbanked: regulatory challenge for state authorities

Credit provision has been a central policy issue for the Indian independent state. This is similar to other post-colonial contexts like Ghana and Kenya which also inherited patterns of high indebtedness from colonial rule (Asuming-Brembong 2013, Nangulu-Ayuku 2007). Chatterjee (2000) argues that the post-independence Indian state sought to distinguish itself from its colonial predecessor through the promise of development for citizens who were no longer non-voting, imperial subjects but citizens. Rural indebtedness in particular had been a principal problem under British rule and independent India's state policies were designed to foster credit cooperatives and replace the share of extortionist moneylenders (Shah *et al*. 2007). With the expansion of microfinance since the 1980s, state authorities began sharing this responsibility for credit provision with private finance institutions.

From the 1980s onwards, central state programmes welcomed and encouraged microfinance as a way of extending credit to low-income women as a target group. National development banks actively encouraged microfinance and facilitated support programmes for financial institutions to expand credit to underbanked women (Chandrasekhar 2016). Rapidly, micro-lending became increasingly financialised as the category of the 'global poor' was made into a source of financial profits (Kleinman 2014, Haldar and Stiglitz 2016). Unbanked women were incorporated into 'formal spaces of the financial economy' (Aitken 2013). While the origins of contemporary micro-loans are often traced to the Grameen Bank set up by Muhammad Yunus in 1983 in his native Bangladesh, the sector soon attracted global interest and capital. Microfinance was recognised as a particularly lucrative sector because of its high repayment rates and relatively high interest rates (Roberts 2013). Global investment banks such as Deutsche Bank (2008), Credit Suisse (2016), ING (2014) and several others, started investing in MFIs in the Global South and many launched microfinance funds that pooled capital from several investors and invested this in Indian MFIs. Alongside international players, India's domestic micro-loan providers transformed into financial institutions and expanded their scale and outreach (Sarma 2011). As this happened, MFIs increasingly became commercialised vehicles that capitalised upon women's debts for profits, often re-entrenching inequalities of caste and class (Guérin *et al*. 2015, Radhakrishnan 2015). Expanding financial appetite for newer products and markets was conducive to pushing microfinance as a key global agenda point, reflected in policy prescriptions by international organisations (Wagner 2012).

In India, the accelerated growth of microfinance soon turned into a major crisis. During fieldwork, MFI staff frequently referred to the Andhra Crisis as a crucial juncture in the trajectory of India's financial services expansion. In a conversation with Mr. Singh, director and founder of a mid-size microfinance institution that had been in operation since 2002, he brought up the Andhra Crisis to remark upon how much the sector had changed since 2010:

> The Andhra Crisis was our biggest crisis … borrowers had committed suicide so of course it was a big issue. My business completely fell apart for a few years. But by 2013, maybe 2014, the RBI had created SROs – MFIN and Sa-Dhan and since then, everything has become much more streamlined … I can easily run my business in any state in the country today.[2]

As he remarks, the Andhra Crisis of 2010 had posed the 'biggest crisis' for the sector. Similar trends were observable in other economies such as Bosnia, Nicaragua and Mexico, where microfinance was transpiring into extraction and becoming a major politically contentious issue (Bernstein 2013). Following the 2008 Great Financial Crisis (GFC), global investors became increasingly interested in microfinance to identify newer, diverse markets for investment. Consequently, the share of private equity in Indian microfinance rose sharply between 2008 and 2010 (Sriram 2010). SKS Microfinance, which became the largest microfinance institution in the country and had been central to the Andhra Crisis, was a frontrunner in this field and became the first Indian microfinance entity to go public with its initial public offering (IPO) in 2010. This attracted global investors such as Goldman Sachs, JP Morgan, Fidelity, Morgan Stanley and George Soros' Quantum Fund who invested in SKS Microfinance, lending it greater credibility and traction in the global financial market (Grunewald and Baron 2011).

This expanding financial interest in micro-loans translated into increasing levels of indebtedness in the state of Andhra Pradesh. Global investors considered Indian microfinance to be relatively low-risk because of high repayment rates. Their increased capital investments ended up oversaturating borrowers with loans and prior to the Andhra Crisis, indebtedness increased to an average of 9 simultaneous loans per household (Dhar 2016). As borrowers' ability to repay crashed in 2010, accounts of borrower suicides appeared. Borrowers organised in protests against coercive collection techniques which included microfinance agents pressing clients to commit suicide so their credit life insurance could be used to repay the loans (Haldar and Stiglitz 2016). As accounts of borrowers' suicides became public and default rates started to rise, SKS Microfinance share prices crashed in 2011 – less than a year after the IPO.

As this crisis unfolded and borrowers' distress drew national attention, state authorities were forced to grapple with the question of defining and regulating this new sector. Since microfinance was resulting directly in harm to borrowers' lives and sustenance, Indian state authorities stepped in to perform their developmental roles and ensure sustenance. As Mr. Singh states above, these challenges were ultimately 'resolved' by introducing SROs under the ambit of the RBI to ensure that the microfinance sector regulates itself. However, this regulatory switch did not come about overnight. In fact, it was heavily contested with diverging standpoints on defining credit to the underbanked. These contestations reveal the politics of regulating contemporary financial services and how state authority is reshaped with increased finance capital that targets the poor. Until the Andhra Crisis, microfinance had been classified as 'moneylending' and hence as a State List issue. The crisis brought forth challenges to define it – is microfinance a 'local' issue that requires regular oversight or a national issue for the central bank? Is credit to the poor something to be controlled or encouraged?

These regulatory questions were debated in the national parliament, state legislative assemblies, courtrooms and policy discussions. State governments advocated for continued categorisation of microfinance as 'moneylending' while central state authorities became proponents for the view that microfinance be classified as a 'financial service' and become self-regulated. These discussions showcase distinct yet simultaneous state logics from different registers ranging from developmental to neoliberal. State governments urged for continued categorisation of microfinance as 'moneylending' and regionally variegated governance in which state governments exercise strong oversight and respond to borrowers' grievances as and when these emerge. In regulating moneylending, state governments historically had the authority to demand inspections, require diligent records and place caps on interest rates (Bose 1994).

The Indian developmental state has to balance between long-term economic planning and democratically responding to popular demands including ensuring survival and basic welfare for marginalised groups. Post-independence state authority derives legitimacy from responding to localised needs and demands. This was evident in the aftermath of the Andhra Crisis itself, where borrowers facing financial pressures mobilised and raised their grievances as a political issue for state intervention. State governments were compelled to make policies that emerge from this negotiation between long-term economic goals and more short-term grievance redressal.

In contrast with this developmental model, central state authorities instead sided with financial institutions in calling for microfinance to be categorised as a 'financial service' which is self-regulated by industry actors instead of state institutions. As a 'service', microfinance was linked to macroeconomic goals including increasing liquidity, separated from borrowers' everyday concerns, demands and challenges. In bringing the sector under 'self-regulation', central state authorities distantiate from responding to citizens' concerns and hand over responsibility to the financial sector itself. Both embedded in international orders and active agents of globalisation, neoliberal state authorities collaborate with financial institutions in shirking responsibility for provision of key services and ensuring protection of marginalised citizens groups. The following sections explore the distinct positions of state governments and central state institutions in regulating and categorising microfinance, which present developmental and neoliberal logics respectively.

Microfinance is moneylending: developmental state and regulation by oversight

In the immediate aftermath of the Andhra Crisis, the Andhra Pradesh (AP) state government announced strict new regulations governing microfinance institutions (MFIs) since these were categorised as moneylenders and hence under direct state government oversight. On 15 October 2010, the state government issued an ordinance that made it mandatory for all MFIs to seek approval from the state's regulatory authority prior to extending any new loan (Government of Andhra Pradesh 2010). This brought all microfinance operations directly under the purview of state oversight. In this, Andhra Pradesh and other state governments argued for retaining and even strengthening their jurisdictional authority over the microfinance sector. The AP government issued a memorandum following the Andhra Crisis, which was presented in parliament and said,

> To quote Dr. Y.V. Reddy, former RBI Governor who stated that for-profit MFIs should be treated at par with moneylenders and should not be subject to soft regulation as they are a bigger risk to the system than individual lenders who extend loans out of their own net worth (Lok Sabha Secretariat 2014).

In this, financial operations were envisioned as a site for state exercise of authority in cases of borrowers' distress. Historically, moneylending legislation in independent India has been protective of borrowers' interests in which state governments and local authorities extend support to borrowers in cases of creditor-borrower disputes (McMahon 2021). Indian Moneylending Acts restrict moneylending business to regions for which the moneylender has been granted a license from the required state governments (Chavan 2003). Reports and official statements issued by the AP government deemed MFIs to be an even bigger threat for borrowers than individual moneylenders because of their bigger size and financial capacity. MFIs' more expansive size was argued to jeopardise individual borrower's ability to negotiate in case of failure to repay. This view continues to remain prevalent among state government actors today. During my fieldwork in 2023, I spoke with a minister for development for a state government in which she described how it was impossible to distinguish MFIs from moneylenders as she said,

> I don't think there's any difference between these microfinance guys and moneylenders. How is it different? They charge so much interest from loans and they go in and target the weakest people, people who have nothing and will not be able to fight back even if they are doing poorly and really cannot repay. We are supposed to look at this and think this is development. What kind of development makes profits from people?[3]

Here she clearly reiterated the long-running argument that microfinance is moneylending. This argument for protecting marginalised borrowers was embedded in histories of debt and state policies governing creditor-borrower relationships in India. This history meant that following independence from British rule, state policies focused on stringently regulating moneylending. As borrowers could face increased threats to their economic survival as a result of debts, state authorities historically saw it necessary to regulate the sector to ensure citizens' welfare and economic sustenance.

Rural indebtedness was a principal problem under British colonial rule. From the nineteenth century onwards, government reports and surveys showed the extent of indebtedness in agrarian India. The Famine Commission of 1880 for instance, documented high debts as closely tied to famines and their high death tolls (Mishra 2013). Similarly, the Deccan Riots Commission of 1878, formed after peasants revolted against conditions of debt peonage, observed how small and continuous loans trap peasants in perpetual debt cycles (Metcalf 1962). British attitudes with respect to moneylending in initial years of imperial rule had been particularly favourable. Moneylenders often doubled up as rent collectors on land and were key intermediaries for both credit and land markets. Malcolm Darling (1925), British civil servant based in Punjab, described the moneylender as ‘banker, dealer and shopkeeper all in one’, revealing the range of powers that the moneylender exercised vis-à-vis the peasantry.

Moneylending regimes under the British were regionally varied with distinct creditor-borrower-tenancy relations, often in relation to the types of agricultural activities pursued in a given region (Klein 2008). Independent India therefore classified moneylending as a state government issue, requiring tailored, regionally variegated regulation to attend to the specifics of regional debt relations. Indian governmental policies vis-à-vis credit provision were reflective of these regional variations. For instance, Regional Rural Banks (RRBs) were established from 1975 onwards as a key state intervention for credit provision. These RRBs were commercial banks with regionally defined operations and state governmental oversight (Mosley 1996, Kher 2013).

Regional, localised differentiation was raised as a key issue by state governments following the Andhra Crisis. With growing challenges in the microfinance sector, the issue drew nation-wide attention and was debated in the national parliament. In 2012, the Microfinance Institutions (Development and Regulation) Bill was introduced in the parliament followed by a parliamentary report on microfinance sector reform by a Standing Committee constituted of members of parliament (Lok Sabha Secretariat 2014). The Bill proposed that the RBI should be made the sector’s principal regulator with the aid of self-regulating mechanisms, but this drew the ire of state governments. The Andhra Pradesh government deemed the Bill to be ‘anti-poor’ and disfavourable to small borrowers (NDTV 2012).

For state governments, borrowers’ distress was a major electoral issue which necessitated governmental response to grievances and credit disputes. In opposing self-regulation and diminishing state oversight, the AP state government strongly argued for continued categorisation of microfinance as moneylending as it said in an official letter responding to the parliamentary Bill:

> Considering that MFIs are primarily involved in lending and recovering of money, and respective state government machinery has ground-level information on lending and recovery practices of the MFIs, the draft should have mandated MFIs to operate within the ambit of the money lending regulations. (NDTV 2012)

The AP government was joined by several other state governments in arguing against self-regulation of the sector. In this view, credit relations were seen to require active state oversight as these could threaten borrowers’ long-term economic survival and it was a developmental state pejorative to respond to localised demands of those at the margins. State governments pressed on this point of active, locally-embedded oversight as they said,

> From 2007 to 2010 … there were only three NBFCs[4] and 80 per cent of those loans were given by those three NBFCs. They were the NBFCs which were under the control of the RBI. They were registered with the RBI, and RBI could not control it. Now, we are talking about a regime where thousands of such MFIs are going to spring up. How can a Central agency control it? (Lok Sabha Secretariat 2014)

In this, localised knowledge and closer state contact with borrowers were seen as essential for ensuring borrowers’ economic well-being. Borrowers’ distress often transformed into a point of political mobilisation and subsequent voting behaviours. In this, credit (from financial institutions or otherwise) has been a point of developmental politics in India. When faced with severe economic distress, borrowers in several Indian states have mobilised to demand state governments to intervene and grant them debt relief. Such instances were also visible during the COVID pandemic when small businesses came to a halt and borrowers' incomes dwindled to dangerously low levels (Narayanan 2024). In state governments' arguments above, financial services require state oversight to provide avenues for borrowers' distress redressal and accountability mechanisms. Since credit relationships underlie microfinance, the sector directly impacts borrowers' economic well-being and is therefore tied up with the balancing responsibilities of the developmental state. In contrast, central state authorities articulated a neoliberal logic in which state role in financial governance is reduced and policies are oriented to align with global financial interests. Central state institutions actively shirk responsibility for financial regulation, borrowers' welfare and credit provision to private finance, as I elaborate in the following sections. This regulatory shift with microfinance has repercussions for financial regulation and state-finance relations in India more widely.

Neoliberal state: fostering microfinance

Prior to the advent and expansion of microfinance described above, central state authorities instituted credit provision as a state responsibility through major policies such as bank nationalisation of 1969. In this, commercial banks were nationalised, and banks were required to lend to marginalised groups at subsidised interest rates. With the liberalisation of the Indian economy in 1991, capital controls were lifted, and state policies were re-oriented towards attracting more capital (Siddiqui 2017). Neoliberal state logics exalted market-based solutions as the most efficient way to deliver essential services (Gupta 2016). In this backdrop of increased liberalisation, microfinance gained rapid popularity and central state authorities actively facilitate MFIs in expanding to new groups and geographies and extend credit to help women survive.

Two important national development banks were established during this period – National Bank for Agriculture and Rural Development (NABARD) in 1982 and Small Industries Development Bank of India (SIDBI) in 1990. NABARD (2000) characterised women as 'natural entrepreneurs' who were 'not created as job seekers … but born as entrepreneurs', calling upon women to self-generate their economic growth and empowerment. Central state institutions cite microfinance as an essential tool for sustaining life at the margins. In a recent government report on the microfinance sector, prepared for members of parliament and in conjunction with the central government's Finance Ministry, microfinance was recognised as essential for ensuring 'economic parity in the country' (Lok Sabha Secretariat 2018). Central institutions deem microfinance as essential for sustaining economic lives of millions of borrowers and as such, come to play an active role in enabling the growth and expansion of the sector.

Development banks executed policies to support the growth of new financial institutions. SIDBI introduced a programme to extend zero-interest loans to non-profit NGOs working in micro-lending in order to facilitate their transition to profit-oriented financial institutions (NBFCs). These were labelled 'transformation loans' and as my interviewee from SIDBI elaborated, these were essential in the growth of more large-scale microfinance:

> We developed a product – We call it a transformational loan. So that was the game changer for the sector … it was a low interest loan was a very soft loan kind of thing with a reduced rate of interest, longer duration. And because the product was structured in a way that they can use it as equity also, it was not a debt, pure debt, it was structured in a way that you can show it as equity. So that helped a lot of organizations transform from not-for-profit into to NBFC and other forms.[5]

Central state authorities incentivised NGOs to turn into financial institutions and expand their client base so that more women could be reached (SIDBI 2011). Recent contributions in international political economy call for more in-depth analysis of state-finance relations and co-constitution (Lagna 2016, Quinn 2017, Karas 2022). These show how finance can provide a renewed from of statecraft through which political elites can reconstitute their exercise of authority (Wang 2020, Petry 2023). Building on these contributions, I observe that increased provision of private finance and credit to the underbanked is encouraged by central state institutions as a replacement for previous state responsibilities. Earlier state policies in India treated credit provision as a state responsibility and instated programmes to extend cheap, subsidised credit to marginalised groups. With microfinance however, credit is provided by private institutions and at far higher interest rates than standard banking loans. For instance, in 2022, a standard personal bank loan charged interest around 10 per cent as opposed to an average of 26 per cent for most micro-loans (RBI 2022, MFIN 2023).

Central state institutions advocate for microfinance loans (even as these charge higher interest) with the rationale that the poor *need* credit. New financial products are encouraged as a means to subsidise the poor, particularly in a time of increased privatisation of public resources such as common land, water and essential services. Increased costs of living with reduced employment opportunities force low-income groups, particularly women, to turn to credit for sustenance. Kar (2018) calls microfinance 'working class credit' which becomes necessary for survival in the absence of viable job opportunities and in the face of reduced government assistance. Similarly, Radhakrishnan (2021) describes women's use of micro-loans in the state of Karnataka as a ploy for 'survival' and Roy (2016) characterises these as an instrument to help 'manage vulnerability'. Neoliberal state policies promote the notion of the 'investor-citizen' (Kaur 2016), who invests in herself through market participation and addresses challenges of poverty and inequality.

Immediately following the Andhra Pradesh government's response and regulatory stronghold described above, MFIN, a pan-Indian association of MFIs brought a case against the AP government in the Supreme Court. In this, MFIN argued against state governments' control over microfinance as these were financial sector services that must come under the RBI (Chakraborty 2013). Large financial players found it challenging to operate under state governments' varied jurisdictional authority and demanded uniform and lighter supervision. This position was supported by central state authorities to ensure that MFIs could continue extending key services. The notion that microfinance was 'essential' kept recurring throughout my conversations with central government employees. One senior executive for the development bank NABARD said,

> Loans are essential, of course women are using these for consumption purposes but that's ok – that's also useful. Loans have always been necessary – the poor cannot survive without these. And if you compare this to old moneylenders, the interest charged by MFIs is much lower so it's a better option for women.[6]

Instead of comparing MFI interest rates to standard bank loans, he was drawing out the superiority of microfinance vis-à-vis traditional moneylenders. Underlying this was the neoliberal risk-based logic that the poorer you are, the more risky and hence susceptible to paying higher interest rates (Martin 2007). This ran contrary to the developmental logic of ensuring credit as a state responsibility and assisting the poor by subsidizing credit access, and instead promoted individuated risk-taking and economic responsibility.

Despite the challenges and harm to life posed by MFIs in Andhra Pradesh in 2010, central state institutions saw microfinance as a necessary sector that must be allowed to grow. The effort was toward standardising and homogenising regulation so as to facilitate nation-wide ease of financial operation. This rationale was well in line with the arguments put forth by MFIs in defence of their sector. MFIN and Sa-Dhan were two networks of MFIs that reacted to the Andhra Crisis by taking the matter of regulating microfinance to court. Following the curtailment of microfinance activity by the Andhra Pradesh government in the immediate aftermath of the crisis, MFIN's case in the Supreme Court argued for including microfinance under the Central government's jurisprudence (Chakraborty 2013). Similarly, Sa-Dhan argued that if MFIs were to be regulated by state governments and registered as moneylenders, then MFI operations would require compliance with multiple, varied state regulations. They criticised this on grounds that it would result in a non-uniform, non-standardised sector, limiting microfinance's outreach and expansion to new borrower populations (The Hindu 2017, Unnikrishnan 2023). Central state institutions similarly cited lack of regulatory uniformity as a limiting factor that could restrict investments in microfinance and consequently hamper the number of loans made to women borrowers. Since microfinance loans were seen as essential for women to survive, central state institutions worked to ensure microfinance expansion.

Birth of the SRO: financial self-regulation as a neoliberal state strategy

The challenge of regulating microfinance was ultimately resolved by rescheduling microfinance from moneylending to a financial service. Financial services come under the ambit of the RBI, which handed over microfinance regulation responsibilities to newly-created self-regulatory organisations (SROs). As MFI operations crashed in the aftermath of the Andhra Crisis, global investors which had previously invested into these MFIs hurriedly left the market which further impacted MFI operations. These investor exits were part of more widespread financial exits from India in the years following the 2008 financial downturn. Searle (2018) for instance, highlights financial exits from the real estate industry during this period as investments could be easily transposed across locations and investee objects. In an attempt to bring back global investments into microfinance, the RBI instated two SROs, the first of their kind in India, to govern the microfinance sector. MFIN and Sa-Dhan, the two microfinance industry associations mentioned earlier, were made into SROs and hence responsible for day-to-day supervision and regulation of the sector. These SROs were constituted of industry actors and their representatives, and their regulatory guidelines were defined by market logics and profit maximisation goals. The RBI flagged SROs as ideal regulators as they abide with market practices and can address issues in cost-efficient, profit-maximising ways. Unlike state governments regulating moneylending, these SROs are not directly accountable to borrowers' grievances. Under the new regulatory system, borrowers are required to complain to the MFI itself (RBI 2011, 2017), a measure that scares off many borrowers from complaining about the MFI to the institution itself.

In the immediate years after the Andhra Crisis, several parliamentary recommendations emerged to regulate the microfinance sector. This included proposals for creating a separate regulatory body composed of representatives from the RBI, development banks, central and state governments and MFIs (Parliament of India 2012). Such a body was supposed to include both state and district-level tiers of representatives who could register feedback and complaints from borrowers. Such proposals fell through because of a lack of consensus among state actors. Instead, this issue was gradually and iteratively 'settled' through court cases, which deemed the RBI and its SROs to be the rightful regulators for the sector. This did away with state oversight of financial operations and state responsibility towards borrowers under economic distress.

National parliamentary reports encouraged the move towards self-regulation as they opposed microfinance regulation to be practised directly by the RBI on top of the already 'onerous duties RBI has to perform as the Central Bank' and did it not see it fit to 'burden' the RBI with another sector (Lok Sabha Secretariat 2014). Much of the regulatory work for microfinance today is carried out by the sector's SROs. One of my interviewees from the RBI's Department of Regulation explained how,

> All of microfinance is now frankly being supervised by SROs … they report to us, but they are in touch with the MFIs and know the sector trends. It's too scattered for us to be peeking into, most of our department has a background in money markets, not this.[7]

He describes microfinance as 'too scattered' to warrant intervention from the RBI or central authorities and rather as capable of self-regulating as a sector. This is well-aligned with prescriptions from international organisations such as CGAP (Christen *et al.* 2012) that argue for 'regulation as promotion' – essentially as frameworks that promote microfinance in furthering more loans. This move towards self-regulation showed an increased neoliberal state reliance on the self-contained power of the financial market to regulate itself if it were given the authority to do so (De Grauwe 2016, Abolafia 2020). Self-regulation is based on the idea that morally correct behaviours must emerge from within the markets and financial institutions and that external, government regulation is not only incapable of regulation but can be detrimental to the functioning of finance (Booth 2020). Starting in the 1980s, neoliberal state policies showed a growing proclivity to ask finance to 'self-regulate' as opposed to enacting and enforcing clear laws and guidelines (Teeple 2011). These were particularly popular in the US and in international agreements, but with the influx of microfinance, also spread to countries such as India which had historically been less inclined to allow private finance to expand without state checks.

My interviewees from central state bodies described this handover of responsibility as making their own work 'hassle-free' and 'mess-free'. A senior RBI executive described co-regulation of microfinance with SROs as particularly favourable so that,

> State authorities can focus on the more important things, my training is not in this kind of work. We can work on larger industry issues with the new insurance market for example … . microfinance is too scattered for us to be managing every day. It's good, the private sector can regulate what it does and handle any issues. They know that if big issues come up, their business is in trouble.[8]

As a central bank, the RBI was more concerned with macro-economic goals rather than everyday economic concerns of low-income borrowers at the margins. Such concerns had previously been governed by state governments which focused on consumer protection. With self-regulation, the rationale was that private finance institutions would manage borrowers' concerns in order to ensure their client retention and profit maximisation. This overlooks instances in which financial interests contradict borrowers' needs, as was the case during the Andhra Crisis.

Conclusion: finance, contested developmentalism and the neoliberal state

Despite the 'resolution' of this debate through the self-regulation model, contestations remain. State governments have repeatedly challenged the designation of microfinance as 'financial services' in High Courts and the Supreme Court.[9] As recently as 2020, the Assam state government passed a Microfinance Bill in the state legislative assembly to regulate microfinance through direct state supervision. Several new regulations were introduced such as, requirements for all MFIs to apply for registration with local authorities, limiting the number of loans that can be given to any single individual or household, and introducing punishment by imprisonment of up to three years in case an MFI is found to be adopting coercive lending practices (Government of Assam 2020). The RBI responded to this by accusing the state government of undermining its authority and demanding that the Bill be repealed. To this, Assam's state-finance minister responded with counter claims on their jurisdictional authority as he said,

> The RBI wrote a letter to me yesterday and asked to consult it before passing the bill. How can the RBI come into the picture? This is a privilege of the House. If I place the letter in the House, the RBI will face a privilege motion. (Kalita 2020)

The Bill had been introduced during a period of borrowers' distress and reports of economic challenges as a result of natural disasters and loss of livelihood. The state government's response here was in line with the Indian developmental state approach described in this paper which requires balancing long-term economic planning with more short-term pressing needs. The story here shows how different strands of state authority can have oppositional viewpoints on financial regulation with some seeking to foster finance while others claiming to curtail it. In India, central authorities propounded neoliberal logics of labelling microfinance as an essential 'financial service' which must be self-regulated by the sector. In contrast, regional authorities demanded jurisdictional control by classifying microfinance as moneylending and hence as a practice that must be closely supervised by the state. Nonetheless, there is an overall trend towards self-regulation, as central state authorities strategically hand over key areas of service provision and regulation to private finance. This adds not only to political economy scholarship on state-finance relations but also to feminist political economy literature on microfinance as it shows that far from being a decentralised practice, microfinance in fact reshapes state authority which carries significant ramifications for women's lives and their avenues for accountability.

This paper shows that microfinance operates not only at the level of incorporating women borrowers into credit relations, but also as a mode of state and regulatory restructuring. As financial services are legally rescheduled, state regulatory authority is rendered transformed. Microfinance continues to expand, often rebranded and included into strategies such as impact investing, financial inclusion and social finance. As these strategies proliferate across transnational boundaries, they present new challenges for state authorities to classify and regulate finance. This story of contestations in regulating the microfinance sector and overall shift towards neoliberal state logics showcases the importance of financial regulation as a domain that reshapes state authority vis-à-vis finance and accountability to citizens.

Notes

1. The Seventh Schedule of the Indian Constitution divides jurisdiction between the central government (or Union government) and state governments. The Indian federal structure has been a point of significant political science scholarship and when compared to federal systems such as the US, the Indian system is often categorised as 'quasi-federal', which blends federal and more unitary aspects (Mazza 2015). However, others argue that this power distribution has significantly altered, particularly with political decentralisation and growth of coalition politics and regional political parties in the 1990s (Arora and Kailash 2018). However, in recent years, there has been an observable shift towards increased centralisation of authority (Jaffrelot and Kalyankar 2017). Hence, the power distributions between these levels of governance change significantly across time.
2. MFI Interview 4, September 2021.
3. State Institutions Interview 5, November 2022.
4. NBFCs are non-banking financial companies which are institutions that can extend credit and financial services similar to a bank, but cannot take deposits from their clients (RBI 2011, RBI 2017).
5. Development Bank Interview 2, December 2022.
6. Development Bank Interview 4, December 2022.
7. RBI Interview 2, October 2022.
8. RBI Interview 1, September 2022.
9. See for instance: Nedumpilli Finance Co Ltd v. State of Kerala (2022), Supreme Court of India. MFIN vs State of Andhra Pradesh (2023), Telangana High Court.

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