

CENTRAL EUROPEAN UNIVERSITY

Beyond the Crowd-out Effect in Microfinance: 'Institutional DNA' and IFI Behavior

A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE DEGREE MASTER
OF ARTS IN INTERNATIONAL RELATIONS AND EUROPEAN STUDIES

INTERNATIONAL RELATIONS AND EUROPEAN STUDIES DEPARTMENT

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4 JUNE 2009

17.274 WORDS

Abstract

In microfinance today, there is active competition between commercial investors and public-sector international financial institutions (IFIs) to fund the top-performing microfinance banks. What is odd is that this occurs in spite of a shared mission for the future of the industry—the emergence of commercial self-sustainability. Commercial advocates have suggested that IFIs are ‘crowding-out’ commercial investors by offering underpriced capital to banks, and that this constitutes a hindrance to the industry’s ongoing success. IFIs have argued that they are further needed, even by the top-performers, to provide financing and guidance. One explanation for this looks at the perverse funding incentives that emerge from the bureaucratic nature of IFIs. Yet this does not explain why IFIs agree with commercial advocates—at least in rhetoric—that their missions should be to cultivate riskier MFIs that are unable to receive funding from commercial sources otherwise. This thesis proposes a supplementary hypothesis to understand IFI behavior that centers on the way worldviews are ‘unpacked’ like DNA to constitute the most fundamental properties of an institution—both its function and its form.

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Introduction

As microfinance continues to transition from a donor-driven social movement into a commercially self-sustaining financial system, the ongoing role of public-sector support to the industry has become a hot topic of conversation. The controversy, as it exists between public-sector institutions and advocates of commercialized microfinance, is not, as one might expect, about the methodologies used by microfinance institutions (MFIs) to deliver financial services to the poor. Regarding this, there is already general agreement that if able, MFIs—the actual ‘mini-banks’ on the ground—should operate in accordance with commercial standards, as the presence of a profit imperative compels them to continually improve their products, delivery, and outreach methodologies, and thus, to sustain their operations from portfolio revenue. Rather, public-sector actors in microfinance engender controversy at a higher level of the capital chain—that involving the financing of MFIs themselves.

This is because public-sector institutions are just one source of financing for an MFI looking to expand its capital base through institutional borrowing. From public-sector sources—international and state-sponsored development banks included under the mantle of international financial institutions (IFIs)—MFIs can tap a steady stream of underpriced financing being put forth to the industry. This has been an important part of the microfinance’s development to date, as savings accounts (where they are offered at all) usually generate insufficient capital to support the full range of a MFIs profitable lending opportunities. Additionally, many MFIs—particularly more recently-established ones—are not able to sustain all their operations from portfolio revenues alone, and require subsidized financing from IFIs until they can reach a level of self-sustainability.

This underpriced (or as I have elsewhere called it, ‘concessional’) financing is an important feature of microfinance’s growth, but is hardly the only source of capital available to MFIs.

Additionally, an increasing number of MFIs have begun to seek capital from private, commercial funds as well, either to replace or supplement the subsidized capital they receive from IFIs. Private capital is usually managed by a microfinance investment vehicle (MIV)—a financial intermediary that pools investment from a variety of individual and institutional sources to buy commercial debt and/or equity from profitable MFIs (thus earning a service fee for itself and returning interest and/or dividends to its own investors). For MFIs, commercial financing may be preferred for the institutional autonomy and long term sustainability it affords, in contrast to subsidized financing, which may be tied to operational conditionality and is bounded in the long run by the often-fickle political mandates of aid-sector bureaucracies. Yet, in the short-term, while commercial loans may have some preferable structuring terms, for example, regarding principle volume, tenor, or amortization, they will always fail when it comes to pricing. By definition, commercial financing is more expensive than concessional capital from IFI sources because public-sector lenders are not as concerned with returns. MFIs must therefore balance these issues when determining where to appeal for capital injections; unlike advocates promoting a particular image of the industry’s overall future, MFIs are relatively more self-interested, naturally, and are therefore more agnostic about the source of their capital, except insofar as the source of capital usually determines the balance of those other factors with which institutional borrowing is associated.

Prima facie, this would seem to create a funding dynamic conducive to the long-term emergence of the industry as a fully-fledged financial system. Initially, newly-seeded MFIs would be compelled to accept underpriced funding and guidance from public-sector sources to support

experimentation with best-practices for lending and due diligence. But later, as these same MFIs develop into viable financial institutions, they should begin to replace public-sector financing with commercial financing in order to establish long-term funding connections with capital markets sources. No longer demanding attention, IFIs should then move on to cultivating a new batch of MFIs until the point at which they too could imbricate within the fold of mainstream money markets. Eventually, a financial system scaled to meet demand from the working poor should emerge at the top, supported underneath by the efforts of IFIs in greenfielding (building new institutions from the ground-up) and supporting the industry's regulatory infrastructure. Such a system would be driven by commercial impulses and seamlessly connected to mainstream financial institutions, affording it long-term self-sustainability and freeing public-sectors interests to devote their resources elsewhere.

However, although present in degrees, the expected flourishing this dynamic would entail has been hindered by the puzzling funding behavior of IFIs in this process. As is well-documented already, IFIs seem to be 'crowding-out'—rather than collaborating with—commercial investors by offering subsidized funding to the best MFI investment opportunities, despite their explicit commitments to invest where commercial actors fear to tread. Of course, for well-established MFIs, it makes little difference where the loans originate, because the IFI funding is cheaper than commercial capital and at their level, is not usually tied to particular operating conditionality. Rather, the concerned parties here are forward-looking industry advocates who wish for microfinance to emerge as a commercially self-sustaining financial systems, therefore regarding commercial investors as a critical linchpin of financial inclusion and 'crowding-out' as a serious hindrance thereof. According to these advocates, since IFIs' own social missions are best supported by extending industry outreach to the greatest extent available, IFIs should actively

burden themselves with a greater balance of the risk-based division of labor by refusing to finance MFIs that could otherwise qualify for commercial financing, funding instead those riskier MFIs in need of concessional capital, for whom a subsidy today may promote sustainability tomorrow.

The tendency of IFIs to displace commercial investors is particularly puzzling because there is in fact (or at least in rhetoric) little disagreement between IFIs' self-purported missions and the sentiments of commercial advocates. Both acknowledge the importance of cultivating linkages to mainstream capital markets financing, as this is widely regarded as the only way to meet the full demand of the working poor for financial services, estimated by industry research at anywhere between \$50 billion - \$100 billion¹. What is so odd here is not therefore the behavior of MFIs, but that despite their expressed convictions, they actively undermine what most agree are the industry's best long-term interests.

Following several years of escalating tension over this, in 2007, a report was commissioned and executed by commercial industry-actors to examine the problem more thoroughly. In the document that ensued, "Role Reversal: Are Public Development Institutions Crowding Out Private Investment in Microfinance?", authors Julie Abrams of Microfinance Analytics, a consultancy, and Damian von Stauffenberg of MicroRate, a premier specialized rater of MFIs, advanced quantitative and qualitative evidence of crowding-out in the industry, supported by several hypotheses for the phenomenon. In the first of these, Abrams and Stauffenberg point to how the 'nature' of IFIs—bureaucratic and democratic—produces perverse incentives to fund the best MFIs, since these constitute the easiest source for capital allocation that can be observed, measured, and touted

¹ DEMAND ESTIMATES ARE HIGHLY INEXACT IN MICROFINANCE. THIS HAS TO DO WITH THE WAY THAT COMMERCIAL VS. NON-COMMERCIAL ARE COUNTED, WHO IS COUNTING, AND BASED ON WHAT PROJECTED TIME-HORIZON. THE LOW HERE IS FROM ROBINSON, MARGUERITE; THE HIGH IS FROM YUNUS, MUHAMMAD.

publically by institutions faced with the existential burden of demonstrating results. That is, by funding the bests MFIs, Abrams and Stauffenberg argue, IFIs can easily allocate large amounts of investment that is likely to be used well, whereas in funding riskier MFIs, IFIs incur more labor to target a greater number of less well-known institutions, with fewer assurances that resources will be allocated efficiently. Additionally, they suggest that in many cases, the industry is accelerating so fast that informational deficiencies prevent a *pareto* efficient coordinating of lending strategies between public and private sector financing sources. IFIs are therefore unaware that they are crowding-out commercial investors, according to this logic.

This would seem to make sense, and indeed, the perverse incentives arising from the bureaucratic structure of IFIs appears suggestive of some insight into the problem of crowding-out. However, this cannot account for the whole story of the crowding-out puzzle. In spite of sharing commercial advocates' hopes and dreams for a future of a fully-fledged commercial micro-financial industry, IFIs *consciously* choose to compete with commercial investors anyways. That is, it is not the case that IFIs are accidentally competing with these investors due to their 'nature,' as Abrams and Stauffenberg argue, but rather, that they don't see their behavior as an obstacle to realizing these long-term industry goals, as their own statements suggest. Furthermore, despite pressure from above to produce results, why wouldn't IFIs simply try to inform those to whom they are accountable of why they now need to take greater risks in funding fledgling MFIs instead?

What emerges from all of this is a two-part puzzle. First, why do IFIs fund better-performing MFIs when it would seem that their resources can be better spent by funding riskier, more recently-established MFIs who need their support more? And second, why is it that commercial advocates and IFIs have reached a harmony in their long-term goals for the industry,

but cannot agree about a basic funding issue that, at present, has created such tension for the industry?

What I want to propose in this thesis is a hypothesis for explaining the deeper causes of these tensions. This hypothesis suggests that all this confusion emerges not because of some specific discrepancy between the way that commercial advocates and IFIs see the microfinance field at present, but from certain incompatibilities that emerge between the fundamental philosophical and intellectual makeup of IFIs, and a field that is increasingly decentralized, privatized, and marketized.

What I will argue is that institutions, such as IFIs, possess a particular ‘institutional DNA’ that dictates their most fundamental characteristics—the function, and their form—and that this can be helpful in understanding the tensions that have emerged. This is not merely to suggest metaphorically that there are underlying philosophical and intellectual strains that generally guide institutions, but rather that certain properties are inherent to institutions and are translated directly through the process in which institutions emerge from inter-subjective understandings of the world—worldviews. Like DNA, I contend, worldviews contain basic informational elements that are then ‘unpacked’ to directly dictate the most fundamental characteristics of an institution.

This helps to explain why IFIs have publicly stated their role as going where commercial investors fear to tread, in the end of building a fully-inclusive micro-financial system, but have continued to commit resources to funding the top-performing MFIs. According to my hypothesis, it is simply in their institutional DNA to do so; being bureaucracies erected to improve conditions in the developing world. They must *do*; the notion of phasing-out support directly contradicts their basic institutional-genetic makeup. While humans may be able to alter a wide variety of their own physical characteristic, for example by dieting, there are nonetheless subject to certain

morphological (relating to basic form and function) properties that are simply beyond their control—they have legs and arms and noses and need nourishment and rest daily. So is it the case that there are basic morphological properties of institutions. In the case of IFIs, this is to suggest that while they may be able to go on a ‘funding diet,’ as indeed they have expressed a great will to do, this can be made difficult by their most fundamental properties.

As I will present it here, due to length constrictions, this remains but a hypothesis that I will argue can supplement to what Abrams and Stauffenberg and others have already suggested as more technical explanations to the problem of crowding-out in microfinance. What is novel to this hypothesis is not of course the idea that institutions are generally governed by a set of fundamental ideas about the world, but rather, that there are certain processes inherent to institutional creation that directly replicate worldviews in the morphology of institutions. That is, that institutional behavior can be a product of institutional DNA. As such, while I develop this concept from the problem of crowding-out in microfinance and believe it can indeed be useful in understanding IFI behavior therein, I make no contentions about having advanced a magic-bullet explanation for all institutional behavior. I will therefore propose the case for *how* this can explain certain elements of these puzzles, but leave it for further research to more fully test the hypothesis against an empirical setting, before suggesting that it necessarily *does* explain them.

The Evolution of Microfinance and the Role of IFIs

This first section serves to reintroduce the practical puzzle in greater detail so that ultimately, the institutional DNA concept that emerges has a real-world frame to support it. Important aspects of this include understanding how microfinance evolved, why it succeeds, and what is at stake for the industry at present. Although young, microfinance has already undergone rapid maturation from a social movement to a financial services industry, now emerging as a viable asset class of mainstream finance. How it got to this point and what role IFIs have played is critical to successfully framing the theoretical sections to come, and an integral part of understanding the potential significance of these insights to the field. In what follows, I will provide this sketch, as the crowding-out puzzle has emerged and evolved.

Microfinance across the Threshold

Over the past several years, microfinance has approached a critical threshold in its evolution, as bulge-bracket investment banks have begun financing the industry directly by underwriting a new class of debt instrument—collateralized debt obligations (CDOs), which pool capital from a diversity of investors to disperse as loans to microfinance banks. The function of CDOs is to establish a class of like investable assets such as microfinance banks, and to underwrite a single security that is backed by these assets, which pays a fixed income to the note-holders. CDOs are typically sold in parts called ‘tranches,’ which form a hierarchy of risk premiums. Aggressive investors can buy lower-level tranches, while bears can stake a senior position in returns. If the fund underperforms, the highest-tranche gets repaid first, then down the chain to the

most junior risk-holders. In the (now infamous) case of US home mortgages, CDOs allowed bankers to invest in a large pool of similar assets, thus mitigating the risk of a single mortgage default, while capitalizing on an economy of scale. The problem here, as has been well-observed in the recent months however, was that the CDO pricing and rating poorly evaluated the risk of the underlying asset pool; in the case of home mortgage CDOs, raters underestimated the probability of a widespread contraction in the housing market.

Nonetheless, where microfinance CDOs are concerned, the results have been relatively more successful. While it is difficult to ascertain up-to-date figures on these transactions, it can safely be said that the industry has launched at least \$500 million via CDOs, which have produced market-adjusted returns—as much as 20%.² The industry has meanwhile benefited from a new influx of capital, as MFIs have used the extra cash to finance new product development efforts, branch expansions, and/or portfolio activity. The benefit of the CDO from an industry perspective is that it allows for the dispersal of large volumes of capital over to an aggregated set of recipients, who alone, could not shoulder such volumes of financing.

However, it is not quite right to suggest that the impulse to produce microfinance CDOs stems from these bulge-bracket investors directly. Rather, while they serve as the final underwriter and help sell the security, much of the legwork that has gone into the CDO market has been the result of innovative fund-development efforts undertaken by professionals from the microfinance investment vehicle (MIV) circle. The first CDO to launch, closing in two parts from 2004-2005, was an \$87 million product, created by a collaboration between Developing World Markets, a microfinance consultancy, Blue Orchard Finance, SA, a microfinance asset manager, and Morgan Stanley.³ MIV players are critical to CDOs because they provide the field knowledge and MFI-

² SWANSON, BRAD. DELIVERED AS SYMPOSIUM ON CREDIT MARKETS FOR THE POOR SPONSORED BY COLUMBIA UNIVERSITY BUSINESS SCHOOL. 20 APRIL 2007.

³ WWW.MIXMARKET.ORG; AN INDUSTRY INFORMATION REPOSITORY

picking expertise necessary to aggregate the right group of assets to underwrite. Their knowledge of mainstream financial culture has been an important part of this process as well; one of the major selling-points of CDOs has been their high risk-premiums, low default rates, and above all, their structural familiarity for investment banks.

Together, CDOs and MIV funds constitute a significant portion of the microfinance industry's capitalization, a share that is increasing rapidly. MicroRate's 2007 survey of MIVs found that from 2006 to 2007, outstanding microfinance assets held by the field had increased 107%, from \$1.48 billion to \$3.07 billion. Despite the financial crash this past fall, preliminary industry reporting suggests that 2008 numbers will be strong as well, as the relative stability of microfinance in contrast to other asset classes is now being widely acknowledged. As other structured financial products are developed for microfinance, the potential volume dispersed to microfinance could grow dramatically.

The Two 'paradigms' of Microfinance

Beyond the capitalization they afford the field, which is, at this point, still modest in relative terms, it is the promise of greater things to come, embodied in CDOs, which has engendered such excitement, causing one scholar to ask whether CDOs are not a 'modern Robin Hood.'⁴ CDOs are a coming-of-age milestone for the industry because they signify microfinance's arrival as a viable and compelling asset class in mainstream finance. Designed to export massive quantities of capital from Western markets to developing-world markets via the microfinance industry, CDOs represent both significant potential for future industry expansion as well as for social progress. For many concerned parties, connecting microfinance to investment bank

⁴ BYSTROM, HANS. "THE MICROFINANCE COLLATERALIZED DEBT OBLIGATION: A MODERN ROBIN HOOD?." MICROFINANCEGATEWAY.COM. JUNE 22, 2006.

capitalization marks a turning point for a social movement striving to become a fully-fledged financial services industry.

All of this—the emergence of microfinance as an asset class—is relatively new however. In fact, initially, the prospect of building a financial system capable of earning market returns for investors was not a prominent objective of the movement’s founders. At its outset, instantiated in the prototype of microfinance, micro-credit, microfinance was not an industry *per se*, but a one-pony social-movement, established to serve poverty alleviation efforts by providing credit to borrowers and thus liberating them from the clutches of loan-sharks and pawn-brokers so that they themselves could reap socially productive returns from their business endeavors. Often, credit programs were complemented by a range of optional or compulsory social services, including savings programs, teaching of literacy and numeracy, health, nutrition, family planning, and industry-specific training.⁵ In this approach to microfinance, the social imperative necessarily trumped the profit imperative.

This model carried microfinance from its emergence in the 1970s through the 1990s, when, as one author puts it, the movement reached a “fork in the road”, divided by fundamentally distinct approaches to microfinance. At one extreme was this “poverty lending” approach, as it had developed from microfinance’s past; at the other was the “financial systems” approach, emergent from the successful demonstration effect of pioneering institutions like BacoSol (Bolivia) and Bank Rakyat Indonesia, and boasting a promising new future for the movement.⁶

While it is clear from today’s vantage that the financial systems approach would predominate in industry discourse and practice, this eventuality should not imply that the financial services approach is categorically superior to poverty lending. It is true that the dynamism of

⁵ ROBINSON, MARGUERITE. *The Microfinance Revolution: Sustainable Finance for the Poor*. THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT/THE WORLD BANK: WASHINGTON. 2001.

⁶ IBID, PP 22.

commercial microfinance fosters greater efficiency and outreach, but the poverty lending approach holds the advantage of being directed and therefore applicable in situations where commercial actors might fear to tread. If, in some cultures, commercial microfinance is unlikely to succeed, for example, because of prevailing social norms about the role of women in society, poverty lending can be an effective way of directing the benefits of microfinance to those who need it most. In disaster situations, few are able to leverage borrowing sufficiently to meet interest payments, but subsidized financial services can be a good way to jump-start the rebuilding process. In other cases, poverty lending is a valuable tool in seeding underdeveloped markets with the day-to-day skills that are necessary for the eventual coming of commercial microfinance, for example, by compelling saving accounts as a condition for credit. And finally, there may be many, such as the extreme poor, for whom the acquisition of debt is socially burdensome, but for whom subsidized financial services can be a great benefit.

At the root of poverty lending is the notion that the social demand for financial services often warrants its provision, even if the commercial viability isn't there. This has been the ethos of many poverty lending programs, and continues to drive microfinance-based poverty alleviation efforts today, both as they are precursors to commercial inclusion and as means to directed social outcomes.

Yet, by the views of this thesis, poverty lending is insufficient to fulfill the expectations that have grown around microfinance. Most directly, its inferiority to the financial systems approach arises when considering the issues of expanding outreach and sustainability. This is because poverty lending is not administered in accordance with commercial principles—there, the lending itself is more important than the return. As such, institutions that subsidize interest rates cannot sustain their operational and portfolio expenses through interest; instead they are subsidized

by the public-sector. This puts a crimp on the prospect for significant expansion, such as to all of those working poor who are qualified for access to financial services. Moreover, given that the estimated market for micro-credit is somewhere between \$50 billion and \$100 billion, it is unlikely that public-sector capital be amassed in such volumes. Marguerite Robinson, the former chair of the Harvard Institute for International Development and an early pioneer of commercial microfinance, described the distinction well:

As a global solution to meeting microfinance demand, the two views on microfinance—and the means they advocate—are not equal. Governments and donors cannot finance the hundreds of millions of people who constitute present unmet demand for microcredit services...The financial systems approach focuses on institutional self-sufficiency because, given the scale of the demand for microfinance worldwide, this is the only possible means to meet widespread client demand for convenient, appropriate financial services.

In short, if microfinance is indeed to constitute the basis of global financial inclusion, it will be because there is a sufficient amount of self-interested capital available to do so. While poverty lending is a worthy endeavor for aid agencies meeting social mandates, it is the widespread outreach of microfinance via commercial success that will provide the greatest form of poverty alleviation in the long run.

Public Sector Institutions in Microfinance

IFIs have played a major role in building this financial system into the industry it constitutes today. From CDOs to greenfielding, to fostering regulatory institutions and funding

information databases, IFIs have demonstrated that they are fully on-board with the commercial revolution in microfinance. This paper should not be mistaken as implying something otherwise. What is so puzzling therefore is that the crowding-out problem exists in the first place, since IFIs and commercial actors alike envision the same ‘financial systems’ future. IFI behavior has not emerged in the abstract, but exists today is part of a continuum of their evolving participation in microfinance. The best way of characterizing this puzzle is by tracing the historical emergence of microfinance and the role played by IFIs therein.

Microfinance was born from a few scattered programs that emerged from the ashes of South Asia’s failed, state-directed, agricultural credit schemes, launched to accompany the green revolution there. During the 1970s, these institutions pioneered stable lending methodologies that formed the basis of proto-microfinance. Peer and rotating lending schemes were an early breakthrough here, used to efface the transaction-inefficiency and default risk that previously had plagued financial services in these areas and to these clients.

Still, in the 1970s, these institutions were NGOs, local credit unions, or state banks—virtually no commercial lender would offer loans to the poor. As such, throughout this period, state aid agencies stepped in to subsidize the cost of capital and lending for institutions. Once, in the 1980s, microfinance had crossed the demonstration-effect threshold, proving to investors that it could sustainably offer financial services to the poor, IFIs became interested in the prospect of supporting the industry as a means of fulfilling their development mandates. IFI support during this period was critical in establishing best-practices codification, building the operating environment for successful financial services provision, and seeding a new class of MFIs. Many of today’s strongest MFI networks, including ProCredit, Compartamos, and the FINCA banks, were founded with IFI-delivered seed capital during this period.

As mentioned, the 1990s marked a turbulent era for the evolution of microfinance, as many banks began to transition from NGO-status into regulated financial institutions, shaking the yoke of public-sector dependence in favor of greater institutional autonomy. IFIs continued to finance MFIs where they could, but increasingly, private-sector commercial capital was being used to for portfolio expansions instead. This period marked the emergence of MIVs as well, and with them, the first time for a need to revisit IFI funding decisions. While the enthusiasm for commercialization during this time spread even to the explicit mission statements of these IFIs, who took it as their mandate to go where commercial investors fear to tread, as Abrams and Stauffenberg have shown, they continued to fill their investment portfolios with a disproportionate share of commercially-qualified MFIs—those whose performance was sufficient to warrant application to commercial lenders instead.

Towards the end of the 1990s and into the beginning of this decade, significant efforts were expended to organize microfinance into a unified platform for financial services intermediation. Data-warehouses, think-tanks, and the like emerged to advise this process from above, seeking to establish working relationship between actors that would facilitate the industry's interests overall. IFIs, remaining significant contributors to the industry, played a major role in this process (in fact, many of these institutions were funded directly by IFIs themselves), and as this organization progressed, it was clear that IFIs would be needed to fulfill critical roles in the future.

Yet for the first time, during this process, the capacity of IFIs to determine their own best-practices in microfinance came under fire. Commercial lenders grumbled about concessional funding decisions, conferences were hosted to discuss the issue, and the Abrams and Stauffenberg report emerged in 2007, sending aftershocks through the industry. Once the established champions

of commercial microfinance, IFIs had already outworn their stay, where certain interests were concerned. Where they should move however, remains an open topic for conversation.

Why Are IFIs ‘crowding out’ Commercial Investors?

As the financial systems approach to microfinance has become a reality over the last decade, the problem of ‘crowding out’—of competition between commercial investors and IFIs generally—has reached a significant volume. As Abrams and Stauffenberg have shown, despite the success of commercial investors in microfinance, in some cases, crowding out by institutional players has occurred.

The authors offer two demonstrations of this effect. In their first, quantitative demonstration, they examine the microfinance portfolios held by IFI funds that have been earmarked for microfinance. Here, they find a growing disproportion of MFIs that would be eligible for commercial borrowing, in contrast to weak holdings of those MFIs actually in needing subsidized capital. Of the four highest rankings that MicroRate, a credit rater, affords to MFIs—alpha, beta plus, beta, beta minus—IFIs’ exposure to alpha-ranked MFIs was over double what it was to beta-plus MFIs, and significantly greater than to beta or beta minus-rated MFIs. Moreover, as Abrams and Stauffenberg observe, this trend is being exacerbated with each year’s lending—in 2005, IFI exposure to alpha-rated MFIs nearly doubled, increasing 88%. Secondarily, Abrams and Stauffenberg offer qualitative evidence to support the crowding out findings, displaying over a dozen cases in which commercial investors have sought to lend to MFIs, but have then been undercut by concessional capital from IFIs.

Although the lion’s share of their report is dedicated to demonstrating *that* the suggested phenomenon is in fact occurring, as this was their most critical obligation from an industry-politics

standpoint, they do offer some suggestion for *why* it is occurring as well (although the relative analytical paucity of their explanations was duly noted in the web conference hosted to further discuss the report). In this vein, Abrams and Stauffenberg aptly suggest:

Whether top decision-makers are aware of it or not, there are powerful incentives for IFIs to maximize their microfinance exposure, and to do so by concentrating on the largest and safest borrowers. A strong reason is the need for IFIs to demonstrate their development engagement. Microfinance has acquired such a positive image, that a sizeable exposure in this sector has become a sign of an IFI's commitment to development. This is reinforced by an IFI's need to disburse its microfinance budget each year, leading to a "*built-in conflict between volume and quality targets.*" IFIs are not primarily profit-driven, thus success is often defined by the amounts that have been lent. Volume become a proxy for development impact. If a budget has been allocated to microfinance, that budget must be spent—and spending it on a few large loans to top MFIs is far quicker, cheaper, and less risky than lending to, and nurturing immature institutions. (quote from Berglof, Erik. *Results Measurement at EBRD*. Emphasis theirs.)⁷

In effect, this is to suggest that the incentive for IFIs to crowd-out commercial investors arises from their institutional structure. That they are result-driven, bureaucratic entities, which exist in the context of a chain of accountability. As far as their institutional interests are served, lending to the top MFIs best fulfills their funding obligations, even if it hampers the industry in the long run. Yet there are several deficiencies with this explanation, although structural considerations are indeed one, immediate and technical explanation for the problem at hand. What is neglected

⁷ ABRAMS, JULIE AND DAMIEN VON STAUFFENBERG. *Role Reversal: Are Public Development Institutions Crowding out Private Investment in Microfinance?* WASHINGTON: MICRORATE, 2007. PP 6.

however is the significance of the “crossfire commentary” presented at the end of the paper and the further comments by IFI managers at the subsequent web-conference. In responding to MicroRate’s request for a comment, KfW, a German development bank, wrote the following:

MFIs are growing so fast, that private sources alone cannot meet their funding needs. They have to fall back on IFI funding...KfW presently makes 3-4 loans annually to Latin American MFIs for \$12-14 million. This volume (compared to the total volume of MFI funding) shows that there is no crowding out.⁸

Furthermore, in the web conference, it was asked whether it even matter who provides the capital, so long as its there. It is apparent that while IFIs and commercial advocates such as Abrams and Stauffenberg do subscribe to the same ideal vision of the future of microfinance, they conceive different strategies for reaching it. MicroRate is primarily compelled by creating the most favorable possible environment for commercial investors, while IFIs, although reticent of the importance of commercial investors, still feel that they are needed to fund even those top MFIs.

The different strategies envisioned in reaching the point of commercial self-sustainability are nuanced to be sure, but are an important explanation for the crowding-out effect and the general tension surrounding IFIs that has emerged. In the sections that follow, I will provide an analysis of wherefrom and how IFI strategies emerge via institutional DNA, of what they consist, and the reason they stand supposedly counterintuitive where commercial microfinance is concerned.

⁸ IBID; PP 18.

From Field to Theory: Conceptualizing the Crowd-out Effect

Abrams and Stauffenberg offer well-established conclusions for why IFIs continue to crowd-out commercial investors from some of the juiciest MFI opportunities. Political imperatives and informational deficiencies are indeed a large part of the puzzle. Yet, behind these immediate causes for the crowding-out effect, I would add that there are intellectual and philosophical forces in play as well.

This has to do with the underlying nature of public sector aid agencies and the way that their *raison d'être* translates via institutional DNA to certain patterns of behavior. Founded in the aftermath of WWII to deliver to the developing world the cornucopias of liberal democracy and capitalism already enjoyed in the West, these agencies take it as their most underlying mandate to *do* something—to affect change from the status quo—in the pursuit of this end. Of course, this implies a particular attitude about the nature of the world, one that will be explored in depth throughout this thesis, which suggests (to put it somewhat simplistically) that the poor are helpless and need those who have already experienced development to show them the way. Directly implying, therefore, that actors in the West have the capacity to control whatever forces have brought poverty in the first place.

Although many would dispute the tenor with which I've advanced these claims (they are indeed much more complicated than this), there is no disputing the presence of a sentiment in the West that we, privileged citizen of the world, are beholden by our privilege to do more for the rest. This is intrinsic to the spirit of Live Aid concerts, to governmental aid pledges, to academic forums discussing poverty, and to the underlying motivation for global social services agencies generally,

including the IFIs at the heart of this paper. As Bono puts it in the introduction to Jeffery Sachs's *The End of Poverty*, “We *can* be the generation that no longer accepts that an accident of latitude determines whether a child lives or dies...It's up to us. We can choose to shift the responsibility, or, as the professor [Sachs] proposes here, we can choose to shift the paradigm.”

This notion of shifting the paradigm is an important characterization of the attitudes that drive development agencies, whether they realize it or not, and is ultimately that which guides the funding decisions of IFIs in microfinance. In what follows, this section explores the way this attitude has emerged in a general sense, ultimately providing the basis for a further exposition of institutional DNA in the section to follow.

Liberal Interventionism in Action: Planning for Development

Before turning how this paradigm is manifested via institutional DNA, it is helpful to reintroduce the issue by discussing Jeffery Sachs's poverty-eradication plan a bit further. The plan, alluded to in the above Bono quote, portrays a good example of the way this intellectual paradigm functions in practice. As Sachs envisions it, naturally, the plan hinges on efforts from the West to finance a series of actions designed to intervene against those forces that have been identified by academics as perpetuating poverty on the ground—government corruption, skyrocketing birth rates, lack of access to education and health services, the absence of employment opportunities, etc... At the root of this is macroeconomic underdevelopment. Sachs believes that poverty is a product, rather than a cause of underdevelopment, and if Western interventions can succeed in creating an industrial, financial, and services infrastructure in the developing world, eventually private-sectors will emerge to produce improvements in other areas as well. As the logic of this plan runs: If we can just figure out how to reverse the forces that

perpetuate these problems in the first place, we can build toward a future in which the poverty of today is but a historical signifier for the progress that has occurred.

This is, to be sure, an extreme simplification of a complex, multifaceted strategy, which, to Sachs's credit, also involves coordination with the potential beneficiaries of development. Nonetheless, the utilitarian, interventionist spirit of liberal internationalism flows freely throughout such a strategy and, more to the point, forms the intellectual basis from which public sector aid and development strategies are crafted and executed. Where the nimble, marketized, financial systems approach to microfinance is concerned, heavy-handed public-sector interventions are much like the proverbial fox minding the hens. Although IFIs are fundamentally distinct from aid agencies *per se*, a belief in the capacity of human reason to rationalize and change the world through action is nonetheless an inexorable part of their institutional DNA. While most IFIs supporting microfinance today have left the 'poverty lending' approach behind, adopting (at least rhetorically) a 'financial systems' mentality, their actions nonetheless retain the vestiges of this mentality. And as Abrams and Stauffenberg's report has shown, when it comes to financing MFIs, these actions speak volumes.

The Underlying Questions at Hand

Do I mean to suggest that Sachs's mentality is somehow wrong: that the West cannot bring about change in the developing world and should mind only its self-interest as a community of nation-states, caring about others only when and if it suits that politically defined self-interest, as the intellectual antithesis to liberal internationalism—neorealism—would suggest?

Certainly not. In spite of its many failures, Western, liberal altruism *can* produce positive change in the developing world. The important role played by IFIs in the evolution of microfinance already suggests as much.

Rather, I have employed Sachs's work to anecdotally illustrate the nature behind the global social services agencies that the West deploys for action in the developing world, including IFIs. Above all, the most important feature of this nature is a general attitude regarding order, reason, and change, as will be shown in the exposition of institutional DNA and which, in Sachs's conception, link rather seamlessly to offer a model for eradicating poverty in our lifetime. In understanding the drivers of IFI behavior regarding microfinance funding, what I will propose is therefore a re-examination of these concepts, as they exist in the abstract and are embodied by IFIs. It is not enough to understand the conditions in which IFIs act, including the incentives and interests that guide their action. We must understand the nature of this action as well. This is the key to understanding the counterintuitive funding behavior they demonstrate.

As such, I am suggesting a supplementary hypothesis to explain why IFIs tend to crowd-out commercial investors in microfinance, derived from an understanding of how the general philosophical and intellectual makeup of public sector development institutions emerges from worldviews and is transplanted directly into their institutional morphology. This hypothesis hinges on the way that public-sector institutions view the world and themselves as engines of transformation therein. It is true, as Abrams and Stauffenberg explain, that the *immediate* reasons for the crowd-out phenomenon are the political, public-relations imperatives faced by IFIs, exacerbated by imperfect market information. But this explanation only takes our understanding of the problem so far, as it fails to account for why these imperatives exist in the first place. The

institutional DNA hypothesis I propose instead addresses a higher-order ‘why’ in explaining the ‘counter-intuitive funding approach’ addressed by their report.

In a palpable way, there are further questions to be asked, the answers to which afford real, useful information to the field. These questions—these different ‘orders’ of ‘why,’ as I have put it—stem from the same direct observation, the crowding out of commercial investors in microfinance by IFIs, but become progressively broader as they inquire deeper.

To begin with, at the most immediate level, Abrams and Stauffenberg have already identified an explanation for the problem at hand. The answer: political incentives—it’s easier for agencies to claim they are doing more today by financing the best MFIs, even if it hurts the industry tomorrow. At a slightly higher order of inquiry, we should ask: where do these political incentives come from? This too is fairly evident and touched upon already by the Abrams-Stauffenberg Report. The answer: a chain of accountability leading from decision makers to governing boards, to the politicians and donors who are shareholders of IFIs, and finally, to the taxpaying citizen of the world. Naturally, when resources are invested at such a large scale, interested parties will want results from their investment and usually, they want them now. It is this particular structure of Western society—democratic and bureaucratic—that fosters, as a byproduct, the particular incentive structure driving the crowding-out effect.

But something lies even beyond this explanation: a more fundamental question about the nature of a society that is structured as such. Given that aid agency behavior is driven by accountability incentives that stem from the self-organizing logic of society: Why have we organized ourselves in this way? Why has Western society given rise to a network of global social services agencies? What is it we are trying to achieve?

(Institutional) DNA

These are some pretty heavy questions that may seem beyond the scope of a paper that purports to advance concepts from the field of International Relations as commentary on the policy challenges faced in the realm of microfinance. However, before I lose my audience here, let me affirm that this is not so. Engaging these questions is the analytical crux of crowding-out since beyond them lie the forces that shape institutions, their missions, and behaviors. These are palpable, discernable forces that translate directly into the immediate phenomena of physical reality—and can be shown to do so. Although the ‘academy’ is often snubbed by the ‘field’ for advancing such arguments, this is not due to their inherent irrelevance but to the widespread failure (or disinterest) of academics to successfully excavate the linkages between the two.

This is the level where institutional DNA enters the pictures. The institutional DNA concept—the underlying intellectual and philosophical encoding that dictates the shape and behavior of institutions—serves to translate these questions into real understandings of why institutions look and act in the ways that they do. Although a general concept, institutional DNA nonetheless represents a potent hypothesis for understanding the specific puzzle posed by IFIs in microfinance. In what follows, the inner-logic of such a concept will be exposed in full.

Institutions and Deoxyribonucleic Acids: an Unlikely Pairing⁹

Generally speaking, institutions are created by societies to fulfill a particular, perceived need. This need is not given *a priori*, but is shaped by the intersubjective attitudes of societies—their observations about the way the world is, their beliefs about the way it *should be*, and their

⁹ I SHOULD SAY HERE THAT I AM DEEPLY INDEBTED TO DOUGLAS HOFSTADTER, WHOSE BEAUTIFUL AND BRILLIANT *Gödel, Escher Bach: An Eternal Golden Braid* HAS UNLOCKED FOR ME THE MANY HIGHER ORDER PROCESSES FOR PERCEIVING MEANING FROM INFORMATION, AND WHOSE DISCUSSION OF DNA—INFINITELY MORE ARTICULATE THAN MINE—FORMS THE INSPIRATION FOR THIS CONCEPT.

conception of what humans can do to achieve this. The purpose of any institution is to bridge the distance between reality on the ground and the ideal image of the future.

For example, the Cato Institute, a libertarian think tank, was founded because of the perceived need “to broaden the parameters of public policy debate to allow consideration of the traditional American principles of limited government, individual liberty, free markets, and peace” (embodied in *Cato’s Letters*). People for the Ethical Treatment of Animals (PETA) was created by advocates endorsing greater animal rights, particularly in laboratory research contexts. Both organizations were erected to fill the gap between the way the world is and the way their advocates thought it should be.

The way that this gap is conceived is of importance here because it implies a particular conception of the world and the role of human societies therein. Moreover, this conception necessarily dictates both the institution’s objectives and the strategies it adopts to achieve them. These conceptions, which form ‘worldviews,’ as they are understood in this context, are the most elementary part of institutional DNA—they dictate the function and form of an institution; how it behaves and the way that it behaves. This is why Cato researchers rarely engage in guerilla-style political activism, but PETA advocates often do.

Expanding this idea, I’ve used the term ‘institutional DNA’ both because I find it a rhetorically effective metaphor for the underlying ‘stuff’—intellectual and philosophical—that an institution is made of, *and* because in many ways, this ‘stuff’ is diagrammatically isomorphic to DNA itself. What do I mean when I say ‘diagrammatically isomorphic?’ What I mean is that DNA is in one sense a metaphor—used to conjure images and ideas that are universally familiar to represent other images and ideas that are relatively more alien. (Everybody knows what I mean

when I talk about DNA, so by tacking on ‘institutional’, I can import these same images to convey what I mean, generally, about the relationship between worldviews and institutions.) However, as metaphors do little to resolve real, practical policy puzzles, I am also interested in using the image of DNA in a more direct way. Literally, therefore, I mean to suggest that DNA shares a degree of diagrammatic isomorphism with the ‘stuff’—the worldview—that underlies an institution. I mean that the structural composition of DNA, including its functional relationship vis-à-vis proteins, cells, and organisms, is (in some, important ways) analogous to the structural composition of worldviews and their functional relationships vis-à-vis the institutions that they engender.

To begin with, a deoxyribonucleic acid (DNA) is a macromolecule composed of monomeric (chemically bonded) nucleotides, made up of organic substances (sugars and phosphates). These nucleotides are arranged in the well-known double-helix, composed of two spiraling, anti-parallel polymer strands (structural, composite-molecules connected by chemical bonds). Between these strands run connecting ‘bars,’ consisting of pairings of nucleobases—the ‘A’s, ‘G’s, ‘C’s, and ‘T’s one sees when DNA ‘code’ is written out in long-hand. What is so remarkable about DNA is that the sequencing (the ordering) of these four simple bases contains a plethora of information about how to manufacture proteins, replicate DNA, construct basic cells, and so on—essentially, the chemical blueprint for constructing an organism.

In the field of genetics, DNA is known as a genotype, while the organism it ‘represents’—that organism’s physically observable properties, development, and behavior—is known as a phenotype. One way to think of a phenotype is as an ‘unpacked’ version of the genotype. It is what emerges when all the instructions have been completed. Flipping this idea, the genotype can also be thought of as a miniaturized, codified representation for the phenotype in which it’s

contained (although here, one needs to be mindful of the causal relationship between genotype and phenotype).

Of course, the idea that things have some underlying encoding which determines their nature is not limited to the field of genetics. In some ways, it is universal to all ‘things’. The notes on a page of music, for example, can be read as the ‘genotype’¹⁰ for the sounds to which they correspond. Ikea’s instructional manuals are the genotype of my desk; they dictate the construction, form, and behavior of the desk—itsself, a phenotype. Of course, when playing music I may omit a dynamic or miss a key signature from here to there, and when building my desk, I may forget a dowel or screw, but this doesn’t change the quality of the underlying genotype, since genotypes are merely sources of information about the full—even unexpressed—properties contained by the music or desk, as the case may be.

What makes this relationship particularly compelling in DNA is that the isomorphism linking genotype and phenotype is significantly more complex than the prosaic isomorphism between sheet music and my (sadly amateur) trombone playing, or between the Ikea instructions and my desk. Whereas I can point to a certain note on the page that associates with a certain sound in the melody, or likewise, I can point to a certain image in the instructions and then find the corresponding screw in my desk, where biological organisms are concerned, this is considerably more difficult. I cannot, for example, point to the specific part of my DNA that corresponds to my pinky-toe (even if I could ‘point’ to a part of my DNA in the first place).

This reason for this is that DNA contains several types of information all at once, embedded together within the sequencing of nucleobases. First, it contains the ‘message’ of the phenotype—information about the organism to be developed (is it blond or brunette, tall or short,

¹⁰ I USE SCARE-QUOTES HERE, BECAUSE IT IS NOT LITERALLY A GENOTYPE, SINCE THE WORD ‘GENOTYPE’ IMPLIES GENETIC, HEREDITARY CHARACTERISTICS; SCARE-QUOTES AROUND GENOTYPE AND PHENOTYPE THROUGHOUT ARE USED TO DISTINGUISH THEIR USAGE AS DESCRIBING GENETIC FROM NON-GENETIC PROPERTIES.

etc...). Secondly, it contains information about which processes should be used for ‘unpacking’ this message—not just what to build, but *how*, chemically, proteins should be manufactured, DNA strands should be replicated, etc... Lastly, it contains decipherment information about how compounds ‘reading’ the DNA can distinguish between these two.¹¹

But despite this, one thing DNA does not contain is a ‘will’ or ‘purpose.’ DNA does not by its mere existence necessitate an autocatalytic process of biological development. Rather, it serves merely to trigger this process in conjunction with certain chemical contexts. Initially, this trigger is the manufacturing of proteins, which then ‘look back’ at the DNA code and find information about what they themselves are supposed to trigger—perhaps the development of basic cells. Triggers beget triggers beget triggers (even the act of one trigger firing-up another is itself a trigger for a whole separate set of triggers) until, ultimately, an organism is produced. The ensuing product is not the result of DNA however, but of millions of chemical reactions. DNA’s role is to provide the informative framework for these reactions. It tells chemical compounds what to produce and how to produce it.

This is not just *similar* to the way that information is ‘unpacked’ from a worldview to form institutions. The processes involved are in fact diagrammatically isomorphic—but with one important qualification.

Here, I should point out that institutions are *not* the ‘phenotype’ associated with the ‘genotype’ of a given worldview. Recalling what I’ve said before about phenotypes—they’re the ‘unpacked’ version of genotypes—it is clear that the ‘unpacked’ version of a worldview is actually the world itself—not the world as we see it today, but the ideal world as envisioned. In this

¹¹ CAVEAT: THIS IS NOT TO IMPLY ANY HIERARCHY BETWEEN THESE TYPES OF INFORMATION; ALL EXIST AT ONCE IN A MUTUALLY-CONSTITUTIVE RELATIONSHIP. THE ORDER IN WHICH I DESCRIBE THEM HAS ONLY TO DO WITH WHAT I EXPECT IS THEIR RELATIVE FAMILIARITY TO THE READER.

process, institutions are simply one of the triggering mechanisms for achieving this worldview. They are, in the sense, like my trombone: the mechanism a given genotype calls for in triggering its final phenotype. When I read sheet music, I am given a series of informational inputs—first, that I need an instrument, and then, how to use that instrument. The ‘phenotype’ of written music is the actual sound-waves that result, whose pitch, volume, tenor, and length are dictated, via this process, by the information contained by some ink on a page.

Therefore, the concept of institutional DNA does not imply that organisms are isomorphic to institutions. In fact, this is a common, erroneous, metaphor. The internal structure and governing processes of organisms—decentralized and non-linear—are actually quite dissimilar from the structure of institutions—hierarchical and bureaucratic.

Instead, what I mean by ‘institutional DNA’ is that a) the kinds information contained by DNA and b) the processes by which information is ‘unpacked,’ are qualitatively equivalent to a) the kinds of information contained by worldviews and b) the processes in by which this information is ‘unpacked.’ Processes *from* which institutions emerge and *to* which they contribute.

While it is therefore incorrect to claim that institutions are the ‘phenotype’ of worldviews, it is not problematic to claim that worldviews are themselves ‘genotypes,’ corresponding to certain ‘world-phenotypes.’ Following this, because institutions emerge part and parcel of a process in which worldview ‘genotypes’ are ‘unpacked’, their institutional DNA is synonymous to the ‘genotype’ of the world they are meant to produce. As such, when we are striving to understand institutional behavior, where we should look is the underlying ‘DNA’—the worldview—upon which they are established.

What is a Worldview?

Of course, it is not sufficient to merely *say* that worldviews function like the DNA of institutions. To fully operationalize the concept of institutional DNA, this needs to be shown. What are the intermediate steps through which worldviews are ‘unpacked’? How is this manifested institutionally?

To answer these questions, we’ll first need to return to the basic component of the institutional DNA concept: worldviews. While I’ve used the idea of a worldview already, describing it loosely as a conception of the way the world functions, a more developed concept is now needed to reveal the isomorphism that exists vis-à-vis DNA. From where do world views emerge and of what do they consist? In what way do worldviews contain—like DNA—the multiple types of information that drive ‘unpacking’ processes?

Unfortunately, there is little academic agreement about what exactly a worldview is. Developed from the German *weltanschauung*, ‘worldview’ has come to mean many different things to many different disciplines. On the one hand, it has been said—drawing on Buddhist philosophical teachings—that all worldviews are but ‘antecedent’ fragments of a transcendent worldview-whole.¹² From the opposite extreme, worldviews have been understood to stem from individual psychological and cognitive—that is to say, neurological—functions.¹³ In the field of International Relations, worldviews have been characterized as “visions of how states interact with one another.”¹⁴ Linguistic philosophers have located worldviews within the syntactical grammar of language.

¹² KAKOL, PETER. “A GENERAL THEORY OF WORLDVIEWS BASED ON MādHYAMIKA AND PROCESS PHILOSOPHIES.” *PHILOSOPHY EAST AND WEST*, VOL. 52, NO. 2 (APR., 2002), PP. 207-223

¹³ STEINER, MIRIAM. “THE SEARCH FOR ORDER IN A DISORDERLY WORLD: WORLDVIEWS AND PRESCRIPTIVE DECISION PARADIGMS.” *International Organization*, VOL. 37, NO. 3 (SUMMER, 1983), PP. 373-413

¹⁴ MOWLE, THOMAS. “WORLDVIEWS IN FOREIGN POLICY: REALISM, LIBERALISM, AND EXTERNAL CONFLICT.” *Political Psychology*. VOL. 24, NO. 4 (SEPT, 2003), PP 561-592.

Complicating this further, even within a given discipline, conflicting understandings of worldview abound. To take the example of International Relations, there are a range of post-positivistic, so-called ‘reflectivist’ sub-schools that would sneer at the above-quoted definition of worldview, suggesting instead that worldviews contain ontological, epistemological, and existential ‘visions’ that are not necessarily connected to the international political-economy of nation-states.¹⁵

To properly characterize all readings of worldview would be an overwhelming task indeed, and not a particularly fruitful one at that, given the way that the worldview concept is used here as but a tool within a conceptual framework specifically-tailored to the empirical problem at hand. One dilemma of surveying worldviews in this way would be disentangling definitions of worldview from the worldview-contexts within which definitions arise. Another would be establishing some metric for comparing worldviews across disciplines.

Fortunately, a comprehensive survey of the worldview literature is not really needed here. This is because we are not necessarily interested the various ways that worldviews have been specifically conceived by others, but in the abstract structural characteristics of worldviews that are relevant to institutions and how they form a DNA-like structure from which these are unpacked. Given the novelty of such a concept, it is simply more effective to infer these characteristics directly from general understandings of worldviews and institutions, than to appropriate out-of-context conceptions of worldviews from elsewhere. After all, the notion of worldview is but an instrument of a hypothesis about microfinance here, and what matters therefore is not the word ‘worldview,’ but rather the specific idea that I have chosen that word to describe—a worldview that is entailed by and relevant to institutional development. Of course, to develop this involves

¹⁵ KRATOCHWIL, FRIEDRICH. “CONSTRUCTIVISM: WHAT IT IS (NOT) AND HOW IT MATTERS.” *Approaches and Methodologies in the Social Sciences*. CAMBRIDGE: CAMBRIDGE UNIVERSITY PRESS. 2008.

revisiting some of the unresolved questions of earlier sections—particularly the questions about how worldviews link to the foundation motivations of institutions.¹⁶

Here, we are brought full circle once again—though not in a tautological, but rather, in a mutually-constitutive manner. Given what I have just said about the worldview concept, on the one hand, we do need a working definition for worldview, such to understand how this concept is ‘unpacked’ in institutional creation. Yet on the other, we need to understand institutional creation in order to develop a relevant concept of worldview. Lacking the capacity to fulfill both needs at once, we are left with nothing but our common-sense and the few axioms we do know already. Fortunately for us, these afford sufficient information to begin this process.

The first set of axioms comes from analytical truths about institutions. Just as it is true that all bachelors are unmarried men, there are certain truisms than can be adduced from the mere existence of institutions. First, institutions are erected by humans. Second, institutions exist in societal contexts. Third, institutions have some purpose.

Another set of axioms can be derived from analytical truths about worldviews. First, worldviews are intangible concepts. Second, worldviews are possessed by humans. Third, worldviews contain information about the world (of which humans are necessarily denizens).

From these, a working understanding of worldview begins to emerge. Given that worldviews are concepts possessed by humans that contain information about the world, and given

¹⁶ THIS IS NOT TO SNUB THE ACADEMY HOWEVER. VARYING CONCEPTIONS OF WORLDVIEWS HAVE BEEN IMPLEMENTED IN MANY PRODUCTIVE WAYS, PARTICULARLY TO EXPLAIN SOCIAL BEHAVIOR, HOWEVER, NOT IN A WAY THAT IS DIRECTLY RELEVANT TO THE INSTITUTIONAL DNA CONCEPT INSTRUMENTALIZED BY THIS HYPOTHESIS ABOUT INSTITUTIONS IN MICROFINANCE. THE PROBLEM IS THAT WHERE WORLDVIEWS ARE USED TO EXPLAIN MACRO-POLITICAL-ECONOMIC PHENOMENA, THEY ARE TYPICALLY USED IN THE GENERALLY METAPHORICAL WAY DISCUSSED ABOVE, RATHER THAN IN THE DIRECT WAY THAT I HOPE TO DEMONSTRATE. IN AN ARTICLE ENTITLED, “THREE WORLDS OR THREE WORLDVIEWS? STATE CAPITALISM AND DEVELOPMENT,” FOR EXAMPLE, THE WORD ‘WORLDVIEW’ IS NOT USED ONCE IN THE TEXT.

that institutions are erected by humans in the context of societies for some purpose, an essential element of worldview seems to be how the notion of order, generally speaking, is conceived. Or, to state this another way: worldviews contain statements about the nature of the world that suggest a certain way of understanding the organizational relationships between things in that world.

Supplementing this, I want to suggest that these statements come from five categories of inquiry, as implied by these axioms. These are: a) ontological—what is the nature of the world?; b) sociological—what is the nature of society?; c) epistemological—what do we know and what can we know?; d) etiological—what is the nature of cause and effect?; and e) praxeological—given all of this, how should we behave? While these ‘logics’ each relate to segments of reality as well as to qualitative properties of worldview, where they matter here is in how they are used to reflect conceptions of order, as suggested in the preceding paragraph and as examined more thoroughly in the subsequent discussion. For now however, it is enough to have established a basis for understanding the categories of information that are contained by worldviews.

Order

By now, we have established two complementary ways of framing the worldview concept. One of these ways describes the qualitative aspects of worldviews with a series of adjectives—ontological, sociological, epistemological, etiological, and praxeological. The other suggests the underlying concept that worldviews are constructed to evaluate—order. Tabling qualitative aspects for the time being (they’ll serve an integral function later though), it is first necessary to elaborate the idea of order a bit further.

What is meant by order here is by no means self-explanatory, as order is a big concept entailing numerous possible interpretations (even excepting obviously irrelevant definitions such

as ‘ordering’ a coffee or issuing ‘orders’ to military battalions), and forms a fundamental element of academic inquiry. In particular, political-philosophy has employed the notion of order to understand how human nature relates to the formation of societies, often drawing a distinction between the presence of order in the domestic realm and the absence of order (i.e. the presence of anarchy) in the international realm. As such, what N.J. Rengger has described as the ‘problem of order’—that is has been conceptually fragmented throughout the evolution of Western civilization—has served as topic of consideration for an all-star team of International Relations theorists¹⁷. Again however, in the interest of parsimony, it is possible to avoid delving into the specific content of these conceptions, since what the concept of institutional DNA suggests is an abstract ‘formula’ for how these conceptions are developed as they relate to institutions. Of course, one specific conception of order that will be of important is that which emerges from the institutional DNA of IFIs, and this will be discussed in greater detail throughout the chapter that follows.

For now therefore, tabling a specific survey of order for another discussion at another juncture in my academic career, where *this* discussion is concerned, what is needed is a more abstract conception of order that can serve as a framework for the way that the question of order is itself framed and developed as worldviews are unpacked in the institutional DNA concept. While even here, there are multiple sources that engage order in this way, the concept adopted by this analysis comes to me by way of James Rosenau, for whom notions of order and disorder play an important role in the theory of “turbulent” world politics he constructs.¹⁸

¹⁷ RENGGER, N.J. “INTERNATIONAL RELATIONS THEORY AND THE PROBLEM OF ORDER.” IN *International Relations, Political Theory and the Problem of Order: Beyond International Relations Theory?* (LONDON: ROUTLEDGE, 2000): 1-33. RENGGER SURVEYS THE CONCEPT OF ORDER IN INTERNATIONAL RELATIONS, INCLUDING KEOHANE, KRATOCHWIL, RAYMOND ARON, STANLEY HOFFMAN, AND R.D. MCKINLAY AND RICHARD LITTLE, DESCRIBING “ALL OF THE ABOVE TREATMENTS OF ORDER [AS] A TENDENCY TO SUGGEST THAT CONTEMPORARY ‘RESPONSES’ TO THE PROBLEM OF ORDER TEND TO BE THREEFOLD: MAINTAIN THE SYSTEM, REFORM THE SYSTEM, OVERTHROW THE SYSTEM.” PP21.

¹⁸ ROSENAU, JAMES. *Turbulence in World Politics*. (PRINCETON: UNIVERSITY PRESS, 1990).

Rosenau deconstructs order in the general sense into two types of abstract order. “Order I,” as Rosenau labels the first of these two, “denotes the presence of causation, the idea that there is a cause for every effect.”¹⁹ This is a relatively more subtle, underlying notion of order, referring not to the state of things being orderly, but to the ordering quality of those forces and processes that shape the world—essentially, that they are non-random. While available technology, resources, and time may be insufficient to successfully observe order I, we take it as an “organizing assumption”²⁰ that it exists—that phenomena do not manifest randomly, but are the direct result of causes that can theoretically be known.

“Order II” meanwhile “focuses on content, on the observed patterns of world politics, on what follows from the systematic stimuli that guide behavior, giving it coherence and rendering it repetitive.”²¹ This is the order that is meant by talk of ‘the global capitalist order,’ an ‘order of nation-states,’ or even the abstract idiom, a ‘fallen order.’ Order II describes a particular grammar in which actors are functionally situated vis-à-vis other actors, serving to articulate where, within the dynamics of a given system, their order falls—if at all.

As order, generally speaking, emerges from our concept of worldviews, there are several important distinctions between order I and order II worth highlighting. The first, most elementary of these, is that order I and order II describe qualitatively different things. Order I describes a *property* of world-governing dynamics (that effects are non-random but rather cause-driven in line with some ‘logic’ that can be hypothetically perceived), while order II describes a *state or condition* of the world (the grammar—whether planned, unplanned, or absent entirely—that functionally organizes world society).

¹⁹ IBID; PP 50.

²⁰ IBID, PP 52.

²¹ IBID, PP 50.

Following this, as Rosenau states explicitly, the existence of Order I is not “a hypothesis to be tested, but an organizing assumption that one holds as a matter of faith and reason.”²² Order II however, *can* be discerned—at least interpretively so—by observing real phenomena. Patterns of military-engagement between nations, fluctuations in GDPs, or the spread of domestic political upheaval, for example, can all serve as indicators of order II.

Where the process of constructing worldviews elaborated above is concerned, each of Rosenau’s orders serves an important function. Order I tells us that world-governing forces possess a causative, comprehensible ‘logic’, while order II tells about the functional grammar of world-society (which, in Rosenau’s view, has been characterized by turbulence in the post-modern epoch). Order I tells us why the world is like it is, while order II describes the way that it is.

One trait held in common by these orders is that their presence carries with it—intrinsically—certain information about the world. The presence of order I, for instance, suggests that the world is governed by causative forces. Order II, where it is present, implies a grammar that organizes world society. The nature of this information is highly abstract however; it is categorical rather than substantive. The content that fills these categories is up to debate and, is so extensively. Moreover, because in the social sciences, even rationalistic, quantitative methodologies are incapable of rendering fully objective conclusions about the world, when it comes to developing a concept of order from a worldview, scholars are forced to interpret, philosophize, and theorize, rather than ‘know’ the content of these categories. This is where these worldview qualities—ontological, sociological, epistemological, etiological, and praxeological—reenter the picture. They serve as categorical modifiers for this interpretive process by breaking

²² *IBID*; PP 51.

down the aspects of the world about which one needs to understand such to then build up a construction of order in the world.

From Worldview to Intellectual Paradigm: How Institutional DNA is ‘Unpacked’

Having sufficiently elaborated the relationship between worldview and order in the preceding sub-sections, an analytical model for the institutional DNA concept can now be adequately developed. Recalling the practical aims of this paper, constructing this model is not itself an endpoint, but rather a means for demonstrating the analytical linkages between an institution’s behavior and its underlying worldview, such that, in the field of microfinance, the puzzling role of IFI behavior can be more deeply understood.

The *sine qua non* of this is therefore the claim that institutions necessarily arise from worldviews, which dictate both the form and function of the institutions they engender. This process is not simply governed by human agents, but rather, is contained by the structure of information embedded within worldviews. In this way, worldviews are not just similar to DNA. They are, rather, in certain, important ways, diagrammatically isomorphic to genetic DNA—each includes the in the same engineering diagram for how information is unpacked to form emergent entities. Just as the multiple kinds of information contained by DNA interact with one another to trigger emergent chemical processes, so are the processes of institutional development triggered by the interaction of the multiple kinds of information embedded in a worldview.

In tracing this isomorphism fully, the processes in which an institution is ‘unpacked’ from the information of a worldview can readily be comprehended, and from this, linkages between institutional behavior and institutional DNA—the embedded information—can be developed. Just as genetic DNA contains the information and process triggers that govern the construction,

morphology, and behavior of biological organisms, so does worldview-information govern the construction, morphology, and behavior of institutions.

Of course, as elaborated in a previous section already, it does not follow that institutions and organisms are isomorphic in this sense. This contention, often found in business-metaphors for example, is simply wrong when a deeper comparison between the two is performed. Structurally and functionally, institutions and organisms are in fact highly dissimilar. Therefore, while organisms are a phenotype that corresponds to a DNA genotype, it would be false to suggest a comparable relationship between institutions and worldviews. Instead, institutions can be understood as triggers themselves, for the process of change in which the existing world is transformed into the corresponding ‘world-phenotype’ of a given ‘worldview-genotype.’

This notwithstanding, suggesting an isomorphism between organisms and institutions is not the reason that the concept of institutional DNA has been developed. Rather, as part and parcel of the process in which the information embedded in worldviews is unpacked toward a certain corresponding ‘phenotype,’ the institutional DNA concept serves to suggest a direct, traceable, and process-driven relationship between worldviews and institutional behavior. Finally, tracing this back to the original motivations for such a concept, this model can then serve to explain some of the otherwise-puzzling behaviors of institutions, simply by deciphering, through this process, their institutional DNA.

The unpacking of this ‘unpacking’ begins with the relationship between the two concepts developed in the preceding sections—worldviews and order. As suggested initially, the concept of worldview used by this analysis naturally entails notions of order. It asks how are things in the world functionally organized? Deciphering this further, there are two different meanings of this

‘how,’ which can correspond to Rosenau’s bipartite description of order. In the first sense, relating to order I, this is to ask: how do forces govern what happens in the world? And in the second sense, relating to order II, this is to ask: how can the organization of the world at present be mapped?

As a way of developing these questions, worldviews further construct statements about the nature of the world by submitting to certain categories of inquiry. The ontological category asks questions about the nature of existence and reality; what are the parameters of experiencing in the world? The sociological category asks questions about the role of humans and the societies they form; how are societies organized and governed, and by what properties and forces? The epistemological category asks questions about the function of knowledge; how do we know what we know about the world? The etiological category asks questions about the nature of cause and effect; why do things occur in the world as they do, what drives this to happen? And finally, the praxeological category asks about the role of human action; how do we act, how should we act, and how *can* we act?

There are of course a range of responses to such questions, depending on the individual, his or her experience with the world, his or her cultural attitudes, and/or his or her education in others’ responses to such questions. A radical epistemological relativist might suggest that there is no knowing reality, being or existence—let alone notions or order in the world; a physical reductionist may regard reality as that which is constituted by the objectively physical world. Those of varying cultural-anthropological persuasions might read societies in terms of culture, ethnicity, nationality, or even language; while others might understand societies in terms of the way organize and govern over natural human tendencies. Certain persons hold that knowledge of the world can be amassed via certain methodologies of inquisition that stem from observations about objective phenomena;

others regard certain categories of knowledge as beyond the capacity for explanation. Some might regard each and every feature of the world as resulting from a direct, causal mapping; stochastic scholars seek to model processes as a combination of determined and random events. Many believe that humans, through action, dictate their own course by controlling world forces; others are skeptical about such a belief. Taken as a whole, these questions form coherent conceptions to the questions about order because they describe the constituent aspects that are involved in interpreting order in the world, thus serving to establish a worldview that is predicated on this interpretation.

These are certainly not all of the responses to the questions asked above, but only some of them, serving as examples for the way that these questions are answered in certain contexts. Of course, the variety of responses imaginable is as wide as the human condition is diverse, and so tracing a comprehensive review of responses is neither achievable nor germane at this point. What matters is *that* there are responses—that, conscious or not, worldview construction involves a basic set of categorical inquiries to develop questions of order, conceptions of which emerge from the responses that are put forth.

What is significant about the process by which worldviews come to ask basic questions about order and then respond to these questions through various categories of inquiry, is that this results in a certain set of information, arranged in a particular way. That is, that worldviews have a certain informational structure, which, I want to suggest, in some, direct ways, is like the informational structure comprising DNA molecules. There is no direct way of responding to the question: ‘what is your worldview?’ Rather, the response that is formulated comes from the way these specific responses are arranged vis-à-vis one another within the context of this structure. In this sense, a worldview is more than the simple sum of these responses; it also contains emergent

properties and conclusions that result from this interaction—from the basic structural diagram that governs information within a worldview.

Beginning to deduce isomorphism from this, we can first say that that the questions of order are like the polymers of this structure—they circumscribe the basic shape of information that is contained within. The various categories of inquiry are then like the nucleotides composing this polymer, giving form to the patterns of interaction that themselves produce emergent information. From here, lastly, the responses themselves are like the nucleobases—they constituent units of information. In genetic DNA, these units are adenosine (A), cytidine (C), guanosine (G), thymidine (T); in institutional DNA, these units are the responses discussed above.

To be very specific about this, the isomorphism I aim to present is not, however, between order-questions and polymers; categories and nucleotides; or responses and nucleobases. There is little similarity to be drawn between concepts and organic sub-molecules. Rather, the isomorphism exists between the structural arrangement of concepts in a worldview and the arrangement of sub-molecules in DNA; and the way this arrangement itself contains information emergent from the this structure itself.

Understanding this structure is the first step to tracing the unpacking processes that results, ultimately, in institutional behavior. This begins with the way that intellectual paradigms are produced directly from this structure. Intellectual paradigms, which are themselves patterns of thought within a discipline, become consolidated as the responses interact to produce emergent conclusions, which are themselves patterned and organized further. For example, a response to the ontological category that suggests that an objective reality does ‘exist’, and a response to the epistemological category that suggests that this reality is perceivable through human faculties, taken together, form conclusions about the capacity of human reason which are not simply the

aggregation of these two responses, but an emergence from the way in which they interact. Adding a response to the etiological category that suggests that causes can be traced directly, conclusions about human reason morph into conclusions about world-rationalization—that things in the world can be understood and dissected to their cause. Adding to this a response to the praxeological category that suggests human action follows from observation, this morphs once more into a conclusion that humans behavior is governed by the tendency to reason, rationalize, and control reality. All the meanwhile, the intellectual paradigm is sorting this information into certain patterns of consistency.

From this, certain theories about order result. Theories describe a specific set of conditions in which phenomena behave in consistently observable ways. That is, through inference, we know that in condition x , effect y will be produced. A theory of order might therefore suggests that when humans use reason to rationalize the world, order is understood and controlled; or the reverse may be theorized. Theories are a direct extension of intellectual paradigms because they emerge from the way that information is coalesced and organized by the former. Theories, coming from *theoria*, suggest another level framework for contemplating the world, but are themselves resultant from broader informational structures—not simply observable phenomena, but from aspects of observational properties engaged by the categorical modifiers. In this way, the process in which theories have been unpacked from worldviews is already the same as the processes that occur in DNA unpacking. In both senses, constituent units of information interact within—and as governed by—a preexisting structure to produce new units of information—in this case, proteins or theories.

In the next step, as these new units ‘look back’ to the original informational structure, institutions begin to emerge. Given that the delineating bounds of a worldview are basic questions about order, and that from these questions, through the steps above, theories about order emerge,

when these theories ‘look back’ to the constituent categorical responses, which include sociological and praxeological categories, the creation of institutions is the natural result. By this I do not necessarily mean to speak about the creation of bureaucracies, but of institutions more broadly, which could include bureaucracies, but might also range to simple cultural conventions. This is because, given that worldviews are interested in the way that the world is functionally organized, that they result in theories about the world, and that the motivation for worldview-construction is human inquisition, it would be a contradiction in terms for humans not to then establish certain behavior-regulating mechanisms (read: institutions) to work with these theories of order. As R.D.McKinlay and Richard Little have argued,

the conceptualization of order purely as pattern is inadequate once we focus on systems involving human intervention. The reason is that humans endow their behavior with purpose and meaning. Human behavior is goal oriented and it is necessary to incorporate goal orientation into a conceptualization of order.²³

Even if it were the case that a worldview resulted in a theory of order suggestive of the human inadequacy to control ordering forces, certain anti-institutional institutions would naturally result. Just the presence of certain mechanical functions in proteins is suggestive of higher-order functioning, so is it the case that the theories of order resultant from worldviews, serving a specific mechanical function, naturally entail the creation of institutions. As Robert Cox has suggested (although for entirely different purposes), “theory is always *for* someone and *for* some purpose” (italics his, underlining mine).

Yet, as I have already suggested, there is at least one further step that needs mentioning here. This is the creation of institutional function and form; and for the purposes of the hypothesis which this analysis serves, is perhaps the most important aspect here. It should be clear now that

²³ QUOTED IN RENGGER; PP 20.

institutional creation is an abstract process—that, although the presence of theories of order entails the creation of institutions, it does not itself entail which institutions to create, for what purpose, and in what shape. Instead, in one sense, institutional function and form is a product of the content of these theories, and in another sense, the way that institutions also ‘look back’ and replicate the original information structure of a worldview, to articulated their behavior. For example, if a particular informational structure was driven by responses about the capacity of humans to perceive the world through reason and to control order through action, this would dictate a certain grammar of institutional function in which processes of world rationalization were used to determine action. If it were the case however that the informational structure was driven by responses about the capacity of humans to perceive the world through reason and about the incapacity to control order, this would dictate a certain grammar of institutional function in which processes of world rationalization were used as responses to phenomena—the behavioral grammar would be reactive rather than proactive.

Here, institutions are functioning vis-à-vis the unpacking process much as cells do. Each are the result of an unpacking process, itself dictated by informational-structural properties. And additionally, each contain an unpacking process as well, replicated from that in which they emerged. Just as the unpacking of worldviews resulted in the founding of institutions, so is institutional behavior unpacked in the world by the same informational structure from which it arose. Cells too are like this; they are the result of DNA, but they also unpack themselves to form bigger biological constructs. To now dawn the ‘metaphor hat’ explicitly: just as cells are the building blocks of organic life, so are institutions the building blocks of societal life.

Unpacking IFI DNA

Having finally developed the in-between processes that allows one to make the case that an institution's given worldview forms its *raison d'être* and in a direct way, is manifested in that institution's behaviors, the time has come to refocus on the question at hand, returning to the IFIs in question and their behaviors in the realm of microfinance funding. In fully exposing this hypothesis—that the crowding-out effect in microfinance is due to the deeper philosophical and intellectual strains that govern IFI behavior—two components warrant further elaboration. First, this involves determining what specific philosophical and intellectual strains have engendered the creation of IFIs in the first place. And second, this involves linking these strains, via the concept of institutional DNA, to certain modes of behavior exhibited by IFIs in supporting microfinance—specifically, their MFI-funding strategies. These will constitute the primary challenges of this chapter, and should serve to bring the hypothesis full circle, from its origins as a policy puzzle, through the exposition of how a worldview is unpacked to form institutional DNA, and finally, to the way that IFIs' specific institutional DNA has been constituted.

What is the IFI Woldview?

For the most part, the emergence of IFIs began with the conclusion of the Second World War, serving as mechanisms to finance the rebuilding of Europe and to support the great number of newly formed states that emerged from the winding-down of the colonial era. The first of these to be developed, and still the most prominent, were the International Monetary Fund (IMF), designed to support and regulate international finance, and the World Bank, which makes loans to

developing nations in the end of supporting their economic development and poverty alleviation efforts.

In ensuing decades, numerous other IFIs cropped up to support regionally targeted lending as well. The African Development Bank, the Asian Development Bank, European Bank for Reconstruction and Development, and the Inter-American Development Bank are the largest and most well-known of these, although many smaller development banks exist as well, such as the Andean Development Corporation—a major champion of microfinance in Latin America. In addition to multilateral development banks, the general heading of IFIs also came to include individual state-sponsored development banks (bilateral financial institutions) such as Netherlands Development Finance Company (FMO) and Kreditanstalt für Wiederaufbau (KfW), the German state development bank

From the time of their founding onward, IFIs have played a major role in international political and economic society, allocating billions of dollars for development projects globally as their funding mandates have expanded to include a wide range of development and poverty alleviation endeavors. Following the conclusion of the Cold War and the acceleration of globalization, IFIs became featured on a wider, fully-global platform as important actors in the increasingly interconnected global economy, perhaps most notably, in their role in the 1997 Asian Financial Crisis. Of course, as part of this, IFIs have been financing microfinance for decades, as detailed in the first chapter of this thesis.

However, although this describes the development of IFIs has been a function the post-WWII era, this is not the whole story of ‘where IFIs come from.’ Rather, recalling what has been earlier said about Jeffery Sachs’s plans to eradicate poverty in our lifetime, IFIs are but a recent act in a longer continuum of efforts by the West to do well by the ‘rest,’ spanning the entirety of

modernity. In fact, as an historical irony, the initial modes of engagement between these two groups, the West and the rest, were the ‘civilizing missions’ of colonialism, the disastrous repercussions of which, centuries later, IFIs would be erected to resolve. From this, IFIs can be understood as emerging from the worldview of liberalism generally, embodying the basic categorical responses set forth by that worldview, and emerging—in form and function, as a result of the institutional DNA suggested thereby.

The Foundations of Liberalism

As a necessary precursor to understanding how the liberal worldview has been unpacked to form the institutional DNA that dictates IFIs’ fundamental morphology—a morphology that this hypothesis holds can be suggestive of their specific funding behavior—it is first necessary to trace the foundations of that worldview as it emerged from historical conditions and the tradition of Western thought that corresponded. Within the analytical confines of this thesis however, the purpose of this is not to paint a complete portrait of the liberal intellectual tradition, as indeed, far better scholars than I have already done so admirably.²⁴ Rather, it is to establish the worldview content that forms the basic units of information in the institutional DNA from which IFIs emerged. That is, to understand the five categories of inquiry and the responses to these held by the liberal tradition, from which IFIs’ institutional DNA results.

A) Ontological—what is the nature of the world?

In the liberal intellectual tradition, a fundamental property of the objective world is that certain

‘natural laws’ exist *a priori* to which all humans are entitled. The notion of liberty being the

²⁴ IN MY VIEW, THE EDOUARD MANET OF THIS IS ACTUALLY NOT A LIBERAL AT ALL, BUT IS EH CARR, WHOSE SELF-DESCRIBED “SMASHING” OF LIBERALISM, THOUGH PRONE TO CERTAIN REBUTTALS AND CRITIQUES OF ITS OWN, ADEPTLY GETS TO THE ROOT OF THESE ISSUES. ALSO, SEE ZACHER AND MATHEW.

catch-all of these, the world is taken as a naturally moral, egalitarian substrate, distorted only by the avarice and conquest of history. By many early-modern liberals, natural law takes its origins from a conception of unity found in the classical world—a harmony between man and the cosmos—to which many practical endeavors were directed to restore. Said John Adams about the founding of the American republic: “I always consider the settlement of America as the opening of a grand scheme and design in Providence for the illumination of the ignorant and the emancipation of the slavish part of mankind all over the earth.”²⁵

B) Sociological—what is the nature of society?

From this, as implied clearly by Adams’ sentiments, it was held that the nature of civil society constituted a fall from this order, engaging man in instead in a brutal competition for resources.

Rousseau sums this well in his 1754 *Discourse on Inequality*:

The first man who, having fenced in a piece of land, said "This is mine," and found people naive enough to believe him, that man was the true founder of civil society. From how many crimes, wars, and murders, from how many horrors and misfortunes might not any one have saved mankind, by pulling up the stakes, or filling up the ditch, and crying to his fellows: Beware of listening to this impostor; you are undone if you once forget that the fruits of the earth belong to us all, and the earth itself to nobody.

Thomas Paine, who’s *Rights of Man* was intended as a rebuttal to Edmund Burke’s cynical *Reflections on the Revolution in France*, also characterizes society in this way:

²⁵ ARENDT, HANNAH. ON REVOLUTION. LONDON: PENGUIN BOOKS, 1965.

The fact, therefore, must be that the individuals, themselves, each, in his own personal and sovereign right, entered into a compact with each other to produce a government: and this is the only mode in which governments have a right to arise, and the only principle on which they have a right to exist.

C) Epistemological—what do we know and what can we know?

Perhaps the most fundamental aspect of the liberal intellectual tradition is a faith in human reason—both the beneficent and pacifying effects of reason, as well as the universal capacity of man for it. Reason was a central theme in the European Enlightenment, as that period emerged from the breakup of the medieval system and papal supremacy to produce a new period of humanist reflection, which, harkening to its classical origins, demonstrated a renewed interest in the consumption of classical modes of philosophical inquiry. As Kant famously described the importance of reason in *An Answer to the Question: What is Enlightenment* (1784): “Enlightenment is man's emergence from his self-imposed tutelage [...] the inability to use one's understanding without guidance from another.”

D) Etiological—what is the nature of cause and effect?

In conjunction with reason, another central aspect of the Enlightenment constituted in the liberal worldview has been the importance of scientific and other technical modes of inquiry. Here, Galileo's use of observation and inference—the scientific method—to unseat Ptolemaic astronomy and replace it with the heliocentric model we ‘know’ today constituted a critical breakthrough for etiological inquiry. From this achievement, described by Stephen Hawking as “the birth of modern science,” and by Thomas Kuhn as marking an shift from one

incommensurable paradigm to another, liberalism developed a fundamental belief in the directness of observable cause and effect processes. While this belief would be modified in contemporary strains of liberal thought reflecting a greater awareness of multilinear processes, it is the unilinear etiological model that has had the greatest impact upon liberalism and which emerges time and again in the logics of global social-welfare agencies, as will be shown.

e) Praxeological—given all of this, how do we behave?

From these aspects of worldview, it follows (although ‘following’ as such is *not* a condition of the institutional DNA model) that human behavior, being reason driven, would naturally conform to rationalist principles. As James Mill suggested in the eighteenth-century, “every man possessed of reason is accustomed to weigh evidence and to be guided and determined by its preponderance.”²⁶ Combined with beliefs about natural law, this suggests about human behavior a natural tendency to act for the collective-interest as an end equal to that of the self-interest. Even through the contemporary era, this has been a primary aspect of the democratic-peace theory.

Unpacking Liberal Worldview: The Emergence of IFIs

Having established the basic units of information needed to trace the process in which institutional DNA is unpacked to form institutions, we can now begin to add substance to the formerly abstract model, such to understand the way in which the liberal responses to these categorical inquiries constitutes IFIs’ morphology. In what follows, I will retrace the steps that

²⁶ QUOTED IN CARR, 1939.

I've already suggested, from the emergence of intellectual paradigms, to theories of order, through institutional emergence, and finally the dictation of institutional behavioral.

To being with, the liberal intellectual paradigm is constructed from the interaction of these basic worldview-statements within the informational structural framework the liberal worldview. Here, while it can be difficult to parse the actual way in which these interactions are produced, as the processes of interaction occur in a non-linear fashion, a basic historical narrative can help provide structure to such a discussion, although it necessarily implies a linearity that is not part of the unpacking process.

In this sense however, reason serves as a central catalyst in the production of emergent information and is a good point of departure for explicating the interaction of liberal views in the formation of an intellectual paradigm. In the most essential way, as Carr has observed about the importance of Bentham in the liberal tradition, liberal views on reason and natural law are combined to form "the [emergent] basis of a rational ethic." Beginning from the postulate that human nature seeks to adduce pleasure, while avoiding pain, this provides the grounds for the emergence of utilitarianism as a categorical moral imperative: that individual behavior should seek "the greatest good for the greatest number of people."

Moreover, this rational ethic, when reflected upon the liberal etiological perspective of directly traceable causality, suggests another linchpin of the liberal intellectual paradigm—a perspective that through sufficient education, any person at any time in any place can be made to abide by this rational ethic. "The obstacle in our path...is not in the moral sphere, but in the intellectual...Is is not because men are ill-disposed that they cannot be educated into a world social consciousness. It is because they—let us be honest and say 'we'—are being of conservative temper and limited intelligence," argues Zimmern²⁷.

²⁷ QUOTED IN CARR, 1939.

From the capacity for intellectual, and thus, moral development, a notion of progress is naturally produced—a notion confirmed for liberalism by evidence of biological evolution developed from the natural sciences. The emergent idea of progress suggests that there are certain ways in which society is ideally arranged—namely liberal democracy and capitalism—that have emerged where they have because of the quality of intelligence held by humans in those societies. Of course, this is an idea that has been modified significantly from its crude, racist formulation in the eighteenth-century, but is nonetheless reflective of the attitudes of Bono and Sachs’s regarding the role of education in bringing development to the world.

Furthermore, as Adam Smith would observe, given the proper conditions, the same competition that drives evolutionary progress in biological organisms is also a mechanism for directing individual interest to serve the collective good. As individuals naturally seek their own self-interests, they will be driven via the engine of competition, as guided by the invisible hand, to produce for the collective-interest as well. Deconstructing this, the harmony of interest is no more an observed relationship between land, labor, and capital, than it is an emergence from the relationship between notions of liberty held by the liberal ontological view of natural law in the world, social libertarianism implied by Rousseau’s quote above, and the belief that humans can be sufficiently educated to foster the natural conditions for *laissez-faire* capitalism.²⁸

While these basic tenets of the liberal intellectual tradition clearly emerged from a historical process of shared intellectual development, from a host of thinkers in a diversity of settings, they can also be produced, in this way, directly from the presence of a liberal worldview itself. That is, given the grammar in which basic liberal worldview statements occur, even absent its piecemeal development throughout history, the liberal intellectual paradigm would be naturally

²⁸ ALTHOUGH IT SHOULD BE SAID THAT SMITH IS CONSIDERABLY MORE COMPLEX THAN THIS, AS ANDREW WYATT WALTER HAS COMMENTED; IT IS NOT SMITH *per se* TO WHICH THIS POINT IS DIRECTED THEREFORE, BUT TO THE NOTION OF HARMONY-OF-INTERESTS AS CONTAINED BY THE LIBERAL INTELLECTUAL PARADIGM.

produced. The significance of such a statement is not to suggest that history is irrelevant, even where institutions are concerned (history is entirely relevant!), but rather that where an institution is founded upon a liberal worldview, this paradigm is inherently, inescapably, contained within its institutional DNA and translated into a determined morphology via informational grammar. Try as they might to escape these conclusions, as certain IFIs have in microfinance endeavored to do, these are necessarily an inextinguishable part of that institutions makeup.

From this, the liberal intellectual paradigm then produces emergent theories to resolve the questions of order—a central component of this being concepts of change. As the notions of rationalization, causality and progress come to suggest, an emergent theoretical component is the notion that the world can be shaped through reason to produce a particular image of the future. More specifically, this is to suggest that facts in the world are malleable to theory about the world, rather than the reverse being true. To put it explicitly, it suggests a theory of order in which order I can not only be rationalized, but can be arrested to produce a specific composition of order II, which is itself determined by the notions of progress implied here. Moreover, given that the collective good necessarily equates with the individual good, even where the unit of analysis is a nation-state or group of nation-states, arresting order in this way *should* occur, for the good of all mankind.

As such, following from this, IFIs, among other institutions, emerge to enact such a theory—to shape the world as the underlying liberal ‘genotype,’ when unpacked to this extent, naturally commands. It is from this that they receive their *raison d’être*—their elemental purpose.

Most saliently where the central hypothesis of this thesis is concerned, this process also produces the modes of behavior that IFIs exhibit. This comes from a replication of the basic

informational structure of worldview-statements at the institutional level, which is then re-unpacked. Here, following from the same logic in which intellectual paradigms emerge, the notions of rationalism, educability, and progress form the backbone of behavior. From the way that orders' malleability has been theorized in such a construction, the notion of rationalism suggests that IFIs' energies can be optimized through the development of strategies of action. That is, whereas certain institutions, such as financial regulatory bodies, seek to respond to systemic change in the world by referring to preexisting frameworks of behavior, IFIs seek to produce change by rationalizing the way that the world will respond to certain strategies—invented frameworks of behavior. Whereas others institutional behavior may be governed by facts in the world, IFI institutional behavior imposes theory upon the world to produce facts. From this, the praxeological view of liberalism suggests that where there is theory, there must be action. And from this, the behaviors observed in microfinance may be said to emerge.

Conclusion: Understanding the Crowding-out Puzzle(s)

This last point cannot be understated, as it is the fundamental crux of the hypothesis I have advanced, from which this thesis sprang, and to which the entirety of the preceding narrative has been devoted; as such, it will be reiterated and elaborated in my final remarks. For now however, I want to suggest several final points about this unpacking process, now that it has been fully described. First, it is a messy one to be sure, but one that can directly be attributed to how institutional DNA is composed by the informational structure inherent to the worldviews upon which institutions are predicated.

Second, in an ideal world, I would have represented this process in terms of the non-linear dynamics that constitute it. The virtue of this would have been to clearly distinguish between a necessarily linear textual explanation and the actual grammars that govern interaction between informational units; still, the isomorphism helps to convey this.

Third, as discussed in the ramp-up to this analysis, this does not suggest that institutions arise simply because there are worldviews out there. Instead, it implies that due to the inherently purposeful nature of institutions, necessarily, they emerge from *some* worldview; in the case of IFIs, this happened to be a liberal worldview, but it need not be so for all institutions.

Fourth, following from this, when I talk about the way that information is unpacked in institutional development, I do not propose to substitute physical processes with conceptual processes. The actual erection of IFIs, for example, is most certainly constituted by actions in the physical reality undertaken by real, human actors—leasing office space, developing an IT infrastructure, soliciting donor capital, all the way down to printing letterhead. Rather, what I mean, as has been made explicit elsewhere, is that the morphology of the institution that emerges from these processes is determined by institutional DNA. Insofar as the third point above holds valid, necessarily, certain information is transmitted to institutions via worldviews that determines a set of fixed properties for an institution. It would be difficult, for example, to image IFIs that did not lend money to developing nations, or use predictive modeling processes to develop strategies for action.

Fifth, there is not necessarily a specific set of morphological properties that are determined by institutional DNA vs. another set of properties that are not. Although the model is still underdeveloped at present, I suspect it is the case that this will vary from worldview to worldview and from institution to institution. What can be said about this however is that those properties

which are dictated by institutional DNA will be the more fundamental of an institution's characteristics; understanding which these are is left to the scholar to determine from the framework provided by the model; this is why, in fact, I am hesitant to advance such a concept as anything more than a supplementary hypothesis. I can only infer whether institutional DNA is explanatorily valuable for reading the behavior in question.

The primary task of this thesis was to propose a supplementary hypothesis for a funding puzzle in microfinance. In rhetoric, commercial advocates and IFIs have reached general agreement that the role of IFIs in advancing the industry is to fund riskier MFIs, while leaving top-performing MFIs to receive commercial capital. Yet puzzlingly IFIs disagree that they are crowding-out commercial investors, despite engaging in direct competition with them at times.

But for this last fact, the explanation offered by Abrams and Stauffenberg—that the bureaucratic and democratic 'nature' of IFIs produces a perverse incentive to fund the easiest, least risky MFIs—would seem to sufficiently resolve the tension. However, given that IFIs agree with Abrams and Stauffenberg's prescriptions, but disagree with their descriptions, something deeper seems to be driving the puzzle.

Here, I have proposed that IFI behavior is actually driven by fixed properties that stem from IFIs' institutional DNA. That is, while IFIs are sufficiently capable of adapting certain properties—such as their public rhetoric—to meet changing facts on the ground, they are incapable of altering other aspects of their institutional-genetic makeup, particularly the aspects of that makeup which suggest that by definition, they exist to form and execute strategies of intervention.

This is not a conclusion that can be demonstrated definitively at this point, but is rather, in my view, a likely candidate to reveal a deeper understanding of these puzzles. In following work, several additional aspects would need to support such a hypothesis, such to establish greater certitude. First, a fully non-linear analytical model would need to be developed to more properly articulate the way in which institutions, like (but not isomorphic to) organisms, emerge from processes of information unpacking that are the same in institutional and genetic DNA. Secondly, an analysis would have to further probe the nature of commercial institutions to adduce what properties of theirs are fixed by their institutional-genetic makeup. Third, a model of optimal microfinance growth would have to be developed against which to compare and contrast division of labor schemes, given the limitations institutional DNA imposes on institutional agility. Given all of this, I suspect that one would find certain impasses in the capacity of commercial and public-sector actors to fully cooperate in supporting the industry optimally, despite a mutual will to do so. Going forward, it seems equally conceivable that these limitations would be diminished or exacerbated by the industry's accelerated commercialization.

While such tasks, unfortunately have not place nor time within the confines of this thesis, they perhaps serve as an basis for future academic research in the field of microfinance to be performed—a basis that is itself an achievement, given the dearth of academic insights in the field at present. One thing that can be said, positively, in conclusions, is that given the extent of cooperation that has occurred in the industry, it does not appear as though such impasses will impede success in the long run, although their further understanding is—this thesis has argued—a worthy dedication of intellectual resources.

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