CHAPTER 1:

Microfinance Investment Funds: Where Wealth Creation Meets Poverty Reduction

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An unacceptably high proportion of the world's population lives in dreadful conditions that consign them to Malthusian lives that are "nasty, brutish and short." While relief and other donations surely help to alleviate poverty temporarily, poverty can be fought decisively only by the creation of wealth where wealth is most lacking, which is among the poor. Wealth creation in this context is broadly defined as improvements in human productivity.

Wealth Creation?

Accordingly, wealth creation is a concept that deserves scrutiny by everyone who seeks to reduce poverty. In fact, it is a more positive and buoyant concept than poverty reduction because it provides a historically productive solution to poverty that has universal application. It includes the poor in a process that empowers them based on the things they can do. This is important because microfinance has shown that the working poor can create significant benefits for themselves with quite small loans. Describing their achievement as wealth creation enhances their dignity in a subtle way that contrasts with poverty reduction, a tough job with a heavy burden that singles them out as poor, unfortunate "others" (even though they constitute the majority of the world's population). Wealth creation may also be a bit more focused than poverty reduction.

The condition of the poor is all the more unacceptable because societies that make up a relatively small proportion of the world's population have found ways, over very lengthy periods of time, that have permitted them to create great wealth, to prosper and enjoy opportunities that would have been unimaginable in earlier generations. This dichotomy – between rich societies and poor ones – is the largest economic and social issue of our time, and also the largest disgrace.

Addressing the possibility of creating wealth among the poor is difficult and slow. One reason for this halting progress is that the institutions that create wealth

are only imperfectly understood. Even where wealth creation has worked relatively well, as measured by various common standards, *perceptions* of the manner in which wealth is created make it very difficult in the current era for the process to be widely admired. Regardless of whether such perceptions are valid, gulfs in levels of wealth remain also in rich societies, causing conflict and violence. Wealth creation is a contentious business. This is highly unfortunate in view of its potential.

Dimensions of wealth creation that are especially difficult for modern society to place in context include sustainability and distribution. Because wealth creation is slow and uncertain, especially in economies that remain stubbornly poor, it is often difficult to comprehend. A central feature of wealth creation is the trade-off between the present and the future, or welfare now versus welfare later, that lies at the heart of every investment and other human endeavour. This conundrum is compounded by concerns about concentration – how is it possible to expand the wealth-creation process to include as many households as possible as rapidly as possible, especially since wealth creation is inherently uneven because capacities to create wealth vary, as does the willingness to take risks?

In view of these concerns and challenges in societies where technology, institutions and location have made wealth creation a matter of routine, what can be said about stimulating wealth creation in poor societies? Here the problems are more complex. Transforming or transplanting into poor societies the institutions that have created wealth in rich ones is subject to even more uncertainty, doubt, and conflict. This is the short history of development cooperation worldwide.

Financial Markets and the Creation of Wealth

Financial markets are subtle institutions based on risk and trust. They are often popularly thought of as the embodiment of wealth, but this perception requires qualification. Wealth in financial form represents only a fraction of a society's wealth, which consists of infrastructure, institutions, and values, all of which determine ways of and scope for transacting. In fact, financial assets are not really wealth. They do nothing on their own; their usefulness lies only in their capacity to stimulate activity and manage risk in the "real" or nonfinancial sectors of an economy. However, financial markets integrate real markets through rates of interest or rates of return that provide a basis for separating good investment proposals, or prospective uses of finance, from poor ones. These rates also help to determine the trade-off between investment and consumption now, and investment and consumption in the future. This gives financial markets considerable power and social utility, and the ways in which financial markets operate have important consequences for the creation of wealth. Other things remaining equal, societies with reasonably efficient financial markets fare better than those without.

Since the 1970s, wealth creation has been made easier by the liberalisation of financial markets. Liberalisation reformed repressive state policy. Reform allowed