

Forum: General Assembly 2 (GA2)

Issue: Measures to promote microloans to increase economic growth in Less Economically Developed Countries (LEDCs)

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Introduction

"Give a man a fish, he'll eat for a day. Give a woman microcredit, she, her husband, her children and her extended family will eat for a lifetime." The lack of formal banking is a persistent barrier in LEDCs for economic growth. Large segments of the population, specifically women, rural communities and minorities, are not part of the formal banking system as they have no access to credit or loans since they lack traditional collateral. This makes them perceived as a high credit risk. Microfinance, which consists of giving especially small loans without collateral, has emerged as a promising solution.

While there was initial euphoria about the success of microfinance in poverty alleviation, new empirical evidence has shown that the impact is mixed. For example, research from 2005 studying microfinance in Bangladesh found significant reductions in village-level poverty, especially among women. (Khandker, 2005) Additionally, multi-country studies suggest that increased access to microcredit can contribute to reductions in income inequality over time. (Lacalle-Calderon et al., 2019) However, other studies are not that sanguine and they indicate that benefits depend heavily on regulatory factors, the presence of reasonable infrastructure and amount of over-indebtedness.

Moreover, LEDCs are furthest from achieving Sustainable Development Goal 1 "No Poverty" and SDG 8 "Decent Work and Economic Growth." One of the main reasons is the persistent lack of access to capital and formal banking infrastructure. Hence, it is important to promote a well-regulated microfinance industry that will help with financial inclusion.

Definition of Key Terms

Least Economically Developed Countries (LEDCs)

UN designated category of low-income countries identified using income criteria, human development, and economic & environmental vulnerability. Currently 44 countries fall under this category. (United Nations Department of Economic and Social Affairs [UN DESA], n.d.)

Microfinance

A broad range of financial services that include credit, savings, insurance, and payment services, generally to low-income people who lack access to formal banking.

(CGAP, n.d.)

Microcredit

A part of microfinance that refers to small loans extended to low-income borrowers, typically given without collateral. (CGAP, n.d.)

Microfinance Institution (MFI)

An organization that provides financial services (microfinance) to the poor. They can be a NGO, a credit union or a bank specializing in small-scale lending. (World Bank, n.d)

Financial Inclusion

Occurs when individuals and businesses have access to financial products and services such as payments, savings, credit, and insurance. (World Bank, n.d.)

Group Lending

Lending to an individual within a self-formed group, whose members share responsibility for guaranteeing loan repayment. (CGAP, n.d.)

Joint Liability

A contractual arrangement that holds the borrowing group responsible for repayment if any individual member defaults.

Social Collateral

A substitute for formal collateral where a person's standing in the community, peer relationships and trust become the collateral in securing loan repayment.

Over-Indebtedness

A state in which a borrower has borrowed above his ability to repay his loans. (CGAP, n.d.)

Multiple Borrowing

A single borrower taking loans from more than one lender or MFI simultaneously.

Interest Rate Cap

A government imposed a ceiling on MFIs, on the interest rate they can charge.

Background Information

Microfinance began as a response to the failure of earlier development approaches, grew into a global industry, and then drifted from the mission it started with. 50 years later, the sector is caught between the social purpose that justifies it and the commercial logic that funds it.

Origins of Microfinance (1970s)

The roots of microfinance came as a development initiative back in the 1970s. The various other developmental initiatives that were in vogue earlier such as government hand outs or grants, low or no interest loans, developed country aid to the poor had all universally

failed to provide the opportunity for the poor to move up the poverty levels. Then an economist Muhammad Yunus began experimental lending to poor artisans in Jobra, Bangladesh, using his own funds. His conviction was that the poor were creditworthy but the banks wouldn't lend to them since they could not provide any traditional collateral such as land, gold, or similar items. So Yunus founded the Grameen Bank, which focused on group-based lending without any physical collateral, relying on trust, group-based accountability and joint liability. These loans were made mainly to women. Repayment of loans was better than what many banks were able to get. Thus, the model spread rapidly across the neighboring countries, especially India. While India is not an LEDC, access to credit for the poor was just as bad as in LEDCs. Given the size of India, the studies on microloans were focused on India. The microfinance industry or opportunity spread globally through the 1980s and 1990s, and was feted as a better option and a market-based alternative to failed state-led poverty programs and top-down foreign aid.

Commercialisation and the Loss of the Social Mission

By the 1990s, microfinance had moved from a niche activity into a global industry. The attractive borrower rates and high repayment made it a very attractive opportunity for commercial banks and subsequently institutional investors. In addition, governments made the industry even more attractive by providing tax and other incentives to lend to microfinance. So a lot of capital started chasing borrowers. Somewhere along this path, the original social mission was lost. Profit motive took over. This remains central to the debates surrounding microfinance today.

Challenges of Delivering Microfinance

Many LEDCs objectively have the least developed formal banking opportunities and have the highest proportions of unbanked populations. This is an ideal situation for the microfinance industry to serve. But in reality, they are also the hardest places to deliver microfinance. There are multiple reasons for this including difficulty of reaching the needy population, credit history of the borrowers, lack of regulatory mechanisms. All of these lead to high cost of debt or interest rate charged to the borrowers. Some LEDCs are also more exposed to extreme weather conditions, conflict, political instability and other disruptive forces.

Past UN Resolutions Addressing the Agenda

As the microfinance industry grew in the 1990s, the UN engaged in this process as a poverty-eradication tool with the following resolutions:

- In 1997, General Assembly Resolutions 52/193 and 52/194 first recognized microcredit's role in poverty eradication.
- In 1998, Resolution 53/197 declared 2005 the International Year of Microcredit with a goal of increasing awareness.

- In 2003, Resolution 58/221 adopted the formal Programme of Action, encouraging regional and subregional microcredit summits.
- In 2004, Resolution 59/246 reaffirmed microfinance's contribution to the Millennium Development Goals.

Organisations and Major Countries Involved

Bangladesh

Modern microfinance began here, with the founding of Grameen Bank in 1983. The Microcredit Regulatory Authority, established in 2006, was among the first dedicated microfinance supervisors anywhere, and it licenses institutions, sets ceilings on charges to borrowers, and monitors over-indebtedness.

India

India has more microfinance borrowers than any other country. It is also where the model failed most publicly. Aggressive lending and coercive collection in Andhra Pradesh triggered a state ordinance in 2010 that caused regional repayment rates to collapse. The Reserve Bank of India's regulatory response, introduced in 2011, now serves as the standard reference for regulating the sector.

Cambodia

Cambodia is an LDC with one of the highest average microloan sizes relative to income in the world. Human rights organisations have documented borrowers selling land to service debts, and the National Bank of Cambodia introduced an interest rate cap in 2017 in response.

United Nations Capital Development Fund (UNCDF)

UNCDF is the UN agency mandated specifically to serve LDCs. It provides seed capital and technical assistance for financial inclusion programmes in exactly the markets where commercial lenders will not operate unassisted. (UNCDF, n.d.)

United Nations Conference on Trade and Development (UNCTAD)

UNCTAD produces the annual Least Developed Countries Report and maintains the statistical baseline against which LDC progress is measured. (UNCTAD, n.d.)

Possible Solutions

Strengthen women's control over microfinance funds through programmes which provide financial education for women, send money directly to their accounts and track whether women can actually control the funds they receive. If these programs are successful, they will ensure that microloans support women's economic independence.

Create government regulations for microfinance that are fair for both the borrower

and the lender. Regulations should be set up to protect people who use these services. They could include making interest rates and repayment terms clear and fair, limiting how many loans a person can take at the same time and creating a reporting system where borrowers can report unfair treatment. These measures would help make sure that expanding access to loans does not lead to people becoming trapped in debt.

With the proliferation of mobile phones even in LEDCs, mobile banking and digital infrastructure have become a key enabling tool in helping modern banking reach even the most remote areas. This will help improve financial literacy among the poor and would help in better utilizing microfinance loans that they can avail. Governments can work with telecommunications companies and financial institutions to expand these services. Here, the solutions should focus on improving financial inclusion as a whole rather than simply increasing the number of microloans

In LEDCs, not all poor households can take and repay a loan. For families living in extreme poverty, direct cash support may be more useful than credit. Governments can provide cash transfers to the most vulnerable households and at the same time offer microfinance to people who are more capable of investing and repaying a loan. This recognises that different groups need different forms of support.

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