EFFECT OF FINANCIAL ORGANISATIONS HAVING ACTIVITY IN THE AREA OF MICROFINANCE : EFFECT ON DEBT IN LESS –DEVELOPED COUNTRIES (LDCs)

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Abstract

Some countries of the world are very indebted. One of the main initiatives leading to amounted debt is the programme of the World Bank Group (WBG) and the International Monetary Fund (IMF), which is known as Heavily Indebted Poor Countries- HIPC Initiative. The mentioned article does not deal with a proper Initiative, but by considering the opinion of financial experts, that one of the main factors of acceptable results are institutions dealing actively with microfinance, whereas in the second part the opinion of other experts is expressed. After analysis, the answer to the above mentioned fundamental issue is expressed in the conclusion, as well as under what conditions the answer is valuable and how micro-financial activities will probably end.

Key words: Microfinancing, Poverty, Critical triangle, HIPC, Risk.

INTRODUCTION

Sub-Saharan Africa (with the exception of the southern-most part of the continent) has a high rate of very indebted states and of poverty. In Sub-Saharan Africa there is a battle between the modern way of life and the traditional way of the world. It occurs because of the interface between the traditional and the European and American lifestyles. The elimination or even reduction of poverty is not possible without appreciating the situation, and without benefiting from the utilisation of the best concepts of these lifestyles.
Firstly, is the understanding of the differences between Steady-state economics (SSE) and standard economics (SE) clearly appreciated? The economic growth perspective (and therefore part of the debt problem) is only possible in exploitation avoidance of certain countries. It is only possible when using SSE principles, and not in submission to the goals, which characterise SE.
Secondly, the balance, which leads to sustainable economic development, taking into consideration that the requirements do not deteriorate, but improve the environment, and at the same time enhances the level of agriculture and therefore reduces poverty. The solution rests inside the so-called "Critical triangle" (environment, agriculture, poverty).
However, there can be no progress without financial capability. High existing debt makes other financial aid of these countries impossible. That is why the HIPC initiative came about. Taking into account that for poor countryside, current financial institutions are almost inaccessible (insufficient guarantees of loan financial resources, absent and conclusive economic history – accounting transparency, high interest rates, etc). In many cases, microfinancial activities are almost the only possible source of financial assistance for stimulating the fortunes of tiny farmers, fishermen, craftsmen, tradesmen and other partners of rural economic activities.
There are formal and informal financial institutions, which are involved in this activity. A necessary feature of this is cooperation with the high-finance organisations, and particularly reciprocal agreements with individual organisations. Here it is possible to find the answer to the question, “Are these institutions one of the main factors leading to the whole mechanism of the HIPC initiative, conducing to reduction of debt?” And in what cases is their activity unproductive? (Indeed, the main condition is the purely economic, political and social environment in particular areas, which open up the way to reasonable and meaningful activities in the countryside).

How do responsible bodies in Sub-Saharan Africa view the issue?

African governments place high priority on developing their indigenous private sector to participate in and lead future growth. This goal is constrained, in part, by the absence of a diversified financial sector capable of meeting the full range of the private sector’s legitimate demand for financial services, especially among small and informal businesses. A related and equally pressing issue is the ability of the self-employed and rural poor to sustain the economic activities essential to their survival. Internationally, a variety of financial institutions have found ways to make lending to the poor sustainable and profitable and to take advantage of the lesson that even the poor self-employed repay their loans and seek savings opportunities. The economy grows in physical scale, but the ecosystem does not. Therefore, as the economy grows it becomes larger in relation to the ecosystem. As you see set principles to a sustainable development is a complex problem of the heavily indebted poor Sub-Saharan countries.

What is it sustainable development? Definitions - according to Holmberg and Sandbrook from 1992, 70 definitions are now current. Pears et al. (1996) include “A Gallery of Definitions” as an appendix to their book. The most widely quoted definition and effectively the official one is that of Brundtland “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. Many other definitions are variants of this, reflecting the disciplinary standpoint of the particular author – many of them say the same thing at much greater length. The apparently simple and clear Brundtland definition has caused heated discussion among theoreticians and practitioners of environment and development. To the authors´ knowledge it has also launched a thousand student essays.
There are a lot of question on the sustainable development in the Sub-Saharan countries indeed. One of the most important questions is following:

Steady-state economics (SSE) or standard economics (SE)?
Economics, which stocks of artifacts and people, are static only the quality of those stocks is rising. People die and artifacts depreciate and births must replace deaths and production must replace depreciation - SSE or Economic which growth is held to be the cure for poverty, unemployment, dept repayment, inflation, balance of payment deficits, pollution, depletion, the population explosion, crime, divorce and drug addition –SE?
African governments give high priority to developing the potential of indigenous entrepreneurs to contribute to the development process and provide employment to the low-income population. In response, the World Bank’s assistance strategy to Africa emphasizes a supportive policy and institutional environment for the indigenous private sector. Within this framework, the strategy differentiates between micro-enterprises, MFIs, and rural households because their development needs differ and because different types of financial institutions may be best suited to serve them. There are existing programs to improve economic situation of these countries. IMF and World Bank Group’s developing program for Sub Saharan Africa for example “Heavily Indebted Poor |Countries (HIPC) Initiative is very good but not a panacea.
The HIPC Initiative was first launched in 1996 by the IMF and World Bank, with the aim of ensuring that no poor country faces a debt burden it cannot manage. The Initiative entails coordinated action by the international financial community, including multilateral organizations and governments, to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. Yet the HIPC Initiative is not a panacea. Where is a principal problem of that programme for Africa?

In June 2000, African Development Bank - ADB approved the Microfinance Development Strategy designed to provide a broad range of financial services such as: deposits, loans, payment services, money transfers, insurance to the poor and low-income households and their micro-enterprises Microfinance services are provided by three types of sources:

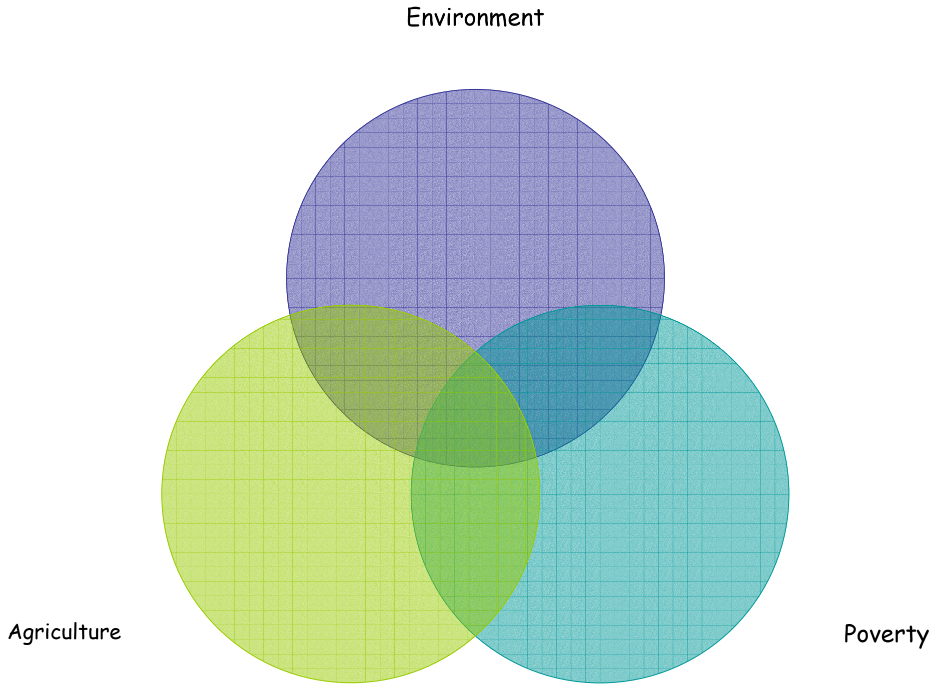
- formal institutions
- semi-formal institutions such as NGOs
- informal sources such as money lenders and shopkeepers

Institutional microfinance includes microfinance services provided by all the informal, formal and semiformal institutions. Microfinance institutions (MFIs) are institutions whose major business is the provision of microfinance services.
The nexus of poverty, agricultural production and environment poses some of the most controversial development policy challenges for international institutions, national policymakers, non-government development agencies, and local communities. Our "mental models" of the relationships between those three points of what call the "critical triangle" of development objectives drives policy and program design Depending on their understanding of those relationships, people who share common goals for poverty reduction, environmental protection and economic change may yet come to very different conclusions on such policy questions as: Shall we focus greater investment in scientific research on development of technologies for marginal or more favored lands?

- Shall we work with poor farmers to make their agricultural practices in critical watersheds more sustainable, or help them find other, non-farming livelihoods?
- Shall we build more roads to help poor farmers earn funds for conservation investment, or restrict road-building to minimize economic activities in vulnerable habitats

The general question is SSE or SE
Researchers have focused considerable attention on analyzing, both theoretically and empirically, poverty-agriculture-environment interactions on an aggregate scale, typically for selected dyads of the critical triangle (Johnson 1998) – chart 1.

Chart 1:



Strategy for fighting poverty

Knowledge and experience gained from "critical triangle"modified the approach of providing human needs in poor countries. Within the framework of unified concept and based on local specific peculiarities the problems are being atomized. This is concerns the exerting of the so called Sustainable livelihood, which is usually defined as: ability, from an environmental point of view, to objectively utilize material, financial, natural, and other resources in order to see to it that the next generation does not have worse starting conditions. Sustainability of this state lies in the ability to bridge stress and shock from fierce hunger, and poverty and the volume of production has an ascending trend; and at the same time it does not harm the environment (Chambers and Conway 1992). The international community must direct their efforts to overcoming any further social shocks in the society (in developing countries).

It is apparent that a partial issue is necessary to solve larger contexts. The optimum solutions lie in the centre of the critical triangle, where agriculture and poverty and environment blend together. Such solutions also correspond to the economic model, which is characterised by Steady-state Economics.

Financial resources and microfinancial activities

During the past 35 years, microfinance has proven itself a powerful poverty alleviation tool. It is one of the only development tools with the potential to financially self-sustaining.

It shows that, microfinancial activities are important components of revival of economic activity of highly indebted countries. Apparently, in some countries there is a decrease in interest rates, reduction of riskiness, revival of economic activity in the countryside, and increase in the ratio of small entrepreneurial subjects to investment resources, etc. Today only a small part of the MFIs capacities is involved in the process to eradicate poverty in LDCs. The Unitus Acceleration Model (UAM) is one of the models which deals with this problem. There are many reasons for the differences between the impact on MFIs activities and responsible investors and commercial banks, on improvements of rural poverty. Some of the main ways in which clients' demands are satisfied are:

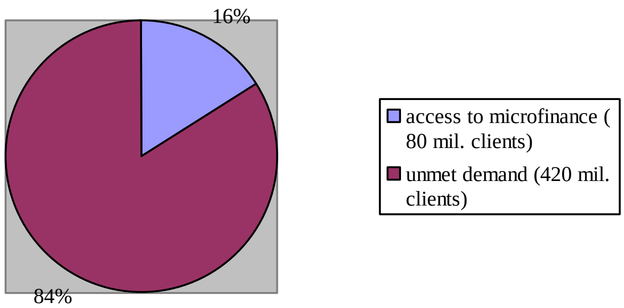
- MFIs have cheaper preferential credits, interest rates are mostly lower than 2%, but they do not have sufficient resources of their own. Foreign resources from investors and commercial banks are expensive
- Indeed, responsible investors and commercial banks have enough financial resources, but interest rates are high (expensive). It follows that the high interest rates make difficult access to resources by MFIs and small businessman in the poor countryside.
- Responsible investors and commercial banks do not have a large enough network of their own representatives in the countryside, because they generally use the traditional infrastructure and relationships between people of countryside, ineffectively. Then, it raises an unbearable risk of loss. Indeed, MFIs provide better cover in some areas, but they do not have enough foreign resources, nor do they always have good co-operation between the informal and formal MFIs.

The overall utilisation of financial resources provided through the IMF shows us calculations of UNITUS.

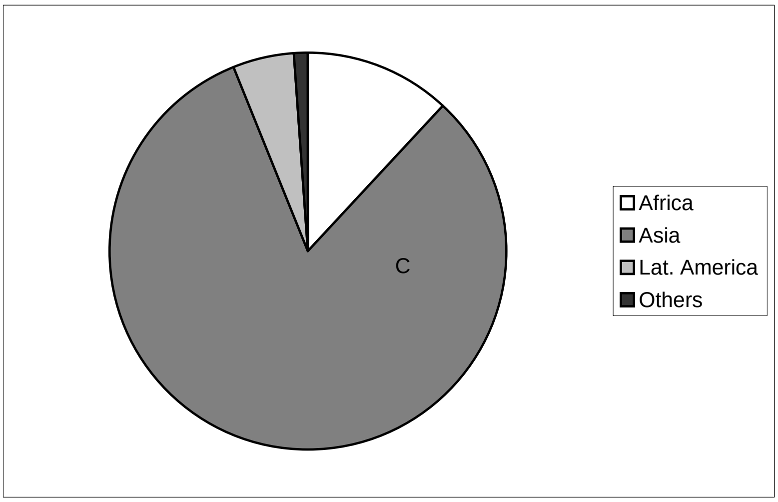
- Estimated global demand is 500 million clients (chart 2)
- Eighty million clients have access to microfinance – 16% (chart 3)
- Four hundred million clients haven't access to microfinance – 84%

Chart 2 and 3:

Estimated global demand



Number of Clients (%)



Source: Data processing according to The Consultative Group to Assist the Poorest (CGAP), 2001-4 (average

The goal of the UNITUS model is to change the situation. MFIs activities are unproductive if formal and informal MFIs do not function together in any given region. It is a backward step if the territory is only under the control of informal institutions. Some experts say that it was a backward step at the beginning of 20th century, and they are right (UNITUS). If formal and informal institutions operate together in the same region, then they positively influence one another. Informal institutions work on decreasing interest rates and thereby on accessibility of financial resources for small businessmen. Formal institutions also work on improving the quality and increasing the variety of financial products, internal disciplines, transparency of its activity, and confidence of investment institutions and commercial banks, which then can reduce the price of financial resources, which MFIs needs as its foreign resources. If the bulk of available financial resources increase, the bulk of MFIs activities as a whole can grow.

The term transformation, or commercialization, of a MFI refers to a chance in legal status from an unregulated nonprofit or non-governmental organization into a regulated, for-profit institution. They are held to performance and capital adequacy standards and are supervised by a financial authority, typically the central bank of the country where are registered. A transformed MFI also attracts equity investors. The equity investors want to ensure that the values of their investments are maintained or enhanced and elect board members who share a common vision for new for-profit institutions (UNITUS).

It is not about all MFIs, because as mentioned above, they have their own relevance.

CONCLUSION

From the article, the following outcomes are:

1. In respect of the need to stabilise the economy of LDC, especially of Sub-Saharan Africa, there are a number of informal voluntary financial organisations, and there is need of their activities. It is necessary to have functional and formal organisations together, in the same areas. The closeness of these organisations leads to the availability of cheap financial resources, and the reduction of corruption and other negative effects. It connects the traditional understanding of economic relationships with new ones which bring, or will economically bring, new technology from the developed world.
2. Generally, SE counters not only the requirements for support of sustainable rural development, but is also unproductive. The financial service finally leads again to high debt. On this bank system there is a provision for new credits not only on principles of loans, but also on services including interests. Simply commodity production the sequence of C – M - C (Money, Commodity). Shifted to M – C - ´M and then back sequence shifted to M - ´M. Thus originating the “Snowball of the debt”.
3. It is obvious that sustainable rural development in LDCs presents the same important challenges to both poor and developed countries. The first point and second point of conclusion generally noted for the truth from the sight of microfinance and macrofinance. It is important to remember that there is no initiative, for example HIPC, which does not meet expectations, without the support of SSE.
4. Transformation of informal MFIs into formal. Transformation must meet the economic development of the environment. Without this transformation, we cannot get along in the future. If the transformation draws aside, and very poor areas of the world do not have secured access to very low financial resources, then there will be a connection of traditional linkages between individual enterprises whilst at the same time maintaining activity of entrepreneurial private subjects, including complex assistance beyond these areas. However, we must anticipate change of the overall economy in any given country, so the transformation becomes a necessity.

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