

"Macroeconomics of Microfinance"

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Taking Uganda as an example (the figures are rounded but in the ball park), the principal source of foreign exchange is by far aid. Exports only finance about 40% of imports and the rest is through aid and concessional borrowing. In 2002 for example, trade deficit was \$ 600 million and grants were \$ 900 million. The share of monetized agriculture is less than 40% of GDP and manufacturing is less than 10% and therefore over 50% of the GDP (with the exception of electricity which is insignificant) is in services and non-tradables. In other words over half of Uganda's economy does not contribute directly to long term sustainable income generation since an economy cannot be sustained by constructing new houses, shopping centers, and more public services alone. <p/>

We know that the bulk of microfinance does not finance agriculture or manufacturing for exports but it goes mostly to petty urban trade and consumption. Moreover we know that poverty is essentially a rural phenomenon (most urban poverty originates in rural poverty) and over 2/3 of the poor live in rural areas and are engaged in mostly subsistence agriculture. In other words, microfinance is maintaining an unsustainable and inequitable economy where people who access finance are likely to spend it mostly on importables, services and construction and these are not the rural poor. Although this might alleviate poverty for those involved in such activities (even here impact is debatable), it is distorting the economy's potential ability to generate sufficient income and exports to sustain itself in the long run. Moreover, petty trade in Uganda is dominated not by local products but by imported products especially fast moving consumables produced by 2 or 3 huge MNCs (Unilever, Coca cola, Procter and Gamble, Nestle, etc.). It seems therefore that the ultimate beneficiaries of microfinance are mostly MNCs and their traders. It is surprising that MNCs don't finance microfinance themselves. I suspect the above holds for most African countries. <p/>

To make microfinance pro-poor, what is needed is a pro-poor growth strategy for the economy as a whole focusing on long term sustainable (and renewable) sectors of smallholder food production, agricultural exports, and non-farm exports. The principal constraints here are transactions costs (especially information costs and contract enforcement costs) and not in production technologies which are available once the market and transactions costs are reduced. Information technology and organizational innovations especially links between producers, exporters and financiers are crucial and such linkages can play a huge role in a pro-poor growth strategy. This also means that the rural poor must become active partners in development (with voice and choice) and not be treated as just "targets" of development schemes that decide on their behalf what they should need. These sectors and activities however are the ones receiving least support and also (not surprisingly) least microfinance. <p/>

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