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Microfinance: An Engine for Global Economic Growth

Tyler Gurss

Innovation is critical for preventing economic stagnation. Sustained macroeconomic growth depends upon the efficient use and investment in human capital.¹ However, billions of potential innovators worldwide do not have the opportunity to reach their potential due to a lack of funds, education, or even access to basic necessities.² In Burma, the banking sector has found it commercially challenging to extend financial access to the poor, resulting in fewer than 20 percent of people having access to formal financial services.³ This is why the U.S. Government has recently begun supporting efforts to set a high standard for responsible business conduct in Burma and encouraging responsible investment in the country as part of an overall strategy to support development and improve the quality of life of the Burmese people.⁴ U.S. companies have responded, and since July 2012 have invested millions of dollars through microfinance in Burma for rural citizens, developing women entrepreneurs, training engineers and managers, and offering apprenticeship opportunities to youth.⁵ Further investment would encourage yet more growth in the most efficient manner possible.

HOW MFI LOANS WORK

Microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services.⁶ Microfinancing Institutions (MFIs) provide low interest loans to entrepreneurs who lack credit.⁷ According to Professor Ramirez of Loyola Law, “The number one problem the economy is facing is a lack of capitalization of the ingenuity and innovation of the impoverished.”⁸

¹ Steven A. Ramirez, *LAWLESS CAPITALISM: THE SUBPRIME CRISIS AND THE CASE FOR AN ECONOMIC RULE OF LAW*, 218 (2013).

² *About Microfinance*, KIVA, available at <<http://www.kiva.org/about/microfinance#II-II>>.

³ Eric Duflos, Paul Luchtenburg, Li Ren & Li Yan Chen, *Microfinance in Myanmar Sector Assessment*, IFC ADVISORY SERVICES IN EAST ASIA AND THE PACIFIC, (2013).

⁴ Office of the Spokesperson for U.S. Department of State, *U.S. Companies in Burma: Doing Business Responsibly* U.S. DEPARTMENT OF STATE, (Aug. 9, 2014), available at <http://www.state.gov/r/pa/prs/ps/2014/230465.htm>.

⁵ *Id.*

⁶ *About Microfinance*, *supra* note 2.

⁷ *Id.*

⁸ Ramirez, *supra* note 1

Gegham Grigoryan is a 48-year-old man who lives in Yerevan Armenia with his wife and two children.⁹ He operates a sewing workshop there where he produces medical uniforms.¹⁰ Gegham initially lacked the funds to expand his business.¹¹ However, he acquired a loan through microfinancing and bought the raw materials necessary to stabilize his business and allow it to grow.¹² There are thousands of would-be entrepreneurs seeking funds for similar needs. Due to the proliferation of computers and the internet over the past decade, a person can use an MFI to help someone like Gegham start a business on the opposite side of the world from them just as easily as they could help a next door neighbor. Although investors may not be able to meet face-to-face with recipients, most MFI websites now allow for members to view the business plans of entrepreneurs and loan according to their level of trust for both the recipient and the loan officer in charge of the loan in question.¹³ This accessibility to information allows for investors to make intelligent decisions about which loans they would like to fund.¹⁴ The result is an extremely low default rate and millions of people finally achieving a semblance of stability.¹⁵

RESULTS OF MFI LOANS

The expansion of microfinance as a tool for developmental aid would help create long-term macroeconomic growth. It is axiomatic that those with the least resources offer the greatest potential for economic growth.¹⁶ Using microfinance, developmental dollars are allocated almost exclusively toward improving the recipients' ability to subsist and thrive, driving the economic growth of the community.¹⁷ MFIs give potential entrepreneurs the opportunity to prove their businesses can be sustainable sources of income for their

⁹ *Success Stories*, VISION MICROFINANCE, available at <http://www.visionmicrofinance.com/en/vision-microfinance/success-stories>.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ About Microfinance, *supra* note 2.

¹⁴ *Id.*

¹⁵ Gerald Pollio & James Obuobie, *Microfinance Default Rates in Ghana: Evidence from Individual-Liability Credit Contracts*, MICROFINANCE INFORMATION EXCHANGE, Nov. 2010, available at <http://www.themix.org/publications/microbanking-bulletin/2010/11/microfinance-default-rates-ghana-evidence-individual-liab>.

¹⁶ Steven A. Ramirez, LAWLESS CAPITALISM: THE SUBPRIME CRISIS AND THE CASE FOR AN ECONOMIC RULE OF LAW, 218 (2013).

¹⁷ *Id.*

community, making them the perfect vehicle for the distribution of developmental funds.

The value of the stability MFIs provide for those on the edge of subsistence cannot be overstated. Simply reaching the level of subsistence has been proven to increase the educational attainment of the children in families affiliated with an MFI.¹⁸ When children are forced out of school early, their opportunities in life immediately become more restricted.¹⁹ According to Professor Ramirez, “Stripping an individual of the ability to reach his or her economic potential retards the extent of the market available to support maximum innovation and specialized knowledge for everyone.”²⁰ The entire world suffers “as any brilliance or innovation [they] could have achieved is likely to go to waste,”²¹ which “leads to grossly underdeveloped markets.”²²

A study published in *World Development* titled “Impact of Microfinance on Schooling: Evidence from Poor Rural Households in Bolivia” found that the children of a family involved with a microfinance institution have an increased likelihood of staying in school.²³ The effect even held true within families with both older children who left school prior to the family becoming affiliated and younger children who gained the additional benefit of being affiliated with an MFI stayed in school longer.²⁴ “[A]ccess to credit and the attending benefits from its profitable usage increases entitlement of program household on education through increasing capability to spend more on education of children.”²⁵ If a family’s home life is stable they are less likely to take their child out of school, helping the child to raise their economic potential.²⁶

THE EXPANSION OF MICROFINANCE THROUGH LEGAL STRUCTURE

Use of MFIs for loan disbursement promotes educated decisions regarding investment, leading to sustained economic growth at the lowest levels of soci-

¹⁸ Jorge Maldonado & Claudio Gonzalez-Vega, *Impact of Microfinance on Schooling: Evidence from Poor Rural Households in Bolivia*, 36 *World Development* 2440, 2450-53 (2008).

¹⁹ *Id.*

²⁰ Ramirez, *supra* note 1, at 131.

²¹ Ramirez, *supra* note 1, at 125.

²² Ramirez, *supra* note 1, at 131.

²³ Maldonado, *supra* note 18.

²⁴ *Id.*

²⁵ Osaore Aideyan, *Microfinance and Poverty Reduction in Rural Nigeria*, 33 *SAVINGS AND DEVELOPMENT* 293, 300 (2009).

²⁶ *Id.*

ety where it is most sorely needed. Investment in human capital leads to innovation, which then leads to new enterprises, increased income and yet more investment in human capital.

Current foreign aid models, even when fully funded, are frequently ineffective when it comes to combating the root causes of poverty at the local level. Boggled down by corrupt governments on the recipients end and politics on the donors end, traditional foreign aid has failed to make a significant impact in many areas. As Professor Ramirez states, “The structure of globalization is designed to maximize profits by multinational corporations.” To combat this, he suggests changing the legal framework to “productively recycle currency reserves into microfinance capital for the impoverished around the world.” The potential for growth through widespread use of MFIs capable of reaching those areas is massive, especially considering the small amount of capital necessary to completely change the economic trajectory of an entire community. This is why the U.S. government is encouraging further investment in microfinance and companies like Coca Cola and Chevron are engaging in and embracing this foreign aid model. When the disempowered like Gegham are given the capital necessary to provide stability for themselves and higher educational attainment for their children, macroeconomic development is the result.