Poverty Alleviation in Nigeria: The Social Impact of Micro-Finance is Greater Than Foreign Government Fiscal Stimulus Packages

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Abstract:

The purpose of this paper is to show that, when done correctly, social impact micro-finance is a better source of poverty alleviation than foreign government aid through fiscal stimulus packages. Using Nigeria as an example, this paper analyzes and evaluates the impacts of the two types of aid. There are pros and cons to each method, but comparatively the results lay in social impact micro-finance's favor. While micro-finance is not a perfect solution, it has the potential to be far more effective. However, social impact micro-finance organizations need to make changes in their operation in order to achieve their objectives. This paper provides recommendations for the changes that must be made to maximize the positive results of social impact micro-financing, specifically in the case of Nigeria.

Keywords: Micro-Finance, Economic Impact Evaluation, Foreign Aid, Nigeria

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Introduction:

> "Deep in every liberal sensibility is a profound sense that in a world of moral uncertainty one idea is sacred, one belief cannot be compromised: the rich should help the poor, and the form of this help should be aid," (Moyo, xviii).

We live in a culture of aid; we subscribe to the notion that giving alms to the poor is the 'right' thing to do, (Moyo, xviii). There are three primary types of aid that we employ: 1) humanitarian or emergency aid, 2) charity-based aid, which is aid given through charitable organizations to institutions or people on the ground, and 3) systemic aid, or aid payments made directly to governments, (Moyo, 7). This paper focuses on the latter two types of aid, and their impacts on poverty alleviation in depressed economies such as Nigeria.

Charity-based aid, like social impact micro-finance, is aid given through non-profits such as Kiva or Microplace. For example, say there are two sisters in rural Venezuela who need US$500 to start a textile company that will aid their local economy and put their children through school. Through organizations such as Kiva, a user can invest a minimal amount, $25 for example, to that specific cause. When the textile company is up and running, and (hopefully) making a profit, the two sisters can pay back their loan. Kiva boasts a repayment rate of 98.45% (Kiva.org). "The goal is to make poor people self-sustaining by helping them start their own business," (Jacobsen),

Systemic aid, or foreign government aid through fiscal stimulus packages, is dispersed to the receiving government in one of two ways: bilateral aid – direct, government-to-government transfers, and multilateral aid – transferred via institutions such as the World Bank, (Moyo, 7).

Nigeria is the most populous country in Sub-Saharan Africa with a population of over 181.5 million people, (World Factbook). Nigeria has an average income of approximately US$8 a day, per capita, ("Nigeria Overview") with vast income inequality among its population. One estimatesaid over 70% of Nigeria's population was below the poverty line, (World Factbook), which accounts for approximately 127,050,000 people. Further, Nigeriahas received over US$1.1 trillion in systematic aid between the years of 2011 and 2014, (usaid.gov). It currently holds almost half a billion dollars (in US$) in microfinance investments spread among 1,513,595 borrowers, which is a significantly lower amount. However, if the same amount of aid was provided through social impact micro-finance as it is provided through systemic aid, social impact micro-finance would be more effective.

Regardless, the "idea of giving small loans to poor people became the darling of the development world, hailed as the long elusive formula to propel even the most destitute into better lives," (Macfarquhar). However, knowledge about social impact micro-finance's impacts is both partial and contested, (Hulme), so the question remains: does it work? If not, how does one make it work?

Those are precisely the questions this paper hopes to answer.

Background:

After World War II, Europe was economically devastated and needed large amounts of economic assistance from the United States to rebuild. The Marshall Plan was a huge success for Western Europe, as well as for the largest donor country, the United States. Western Europe was able to rebuild economically and the United States developed both a political ally and large trading partner. The Marshall Plan laid the foundation for NATO and the Treaty of Rome in 1954 that launched the project on European integration. Around the same time, there became an "international awareness that poverty anywhere is dangerous to prosperity everywhere and prosperity anywhere must be shared everywhere," (Abidemi). Consequently, in the name of ensuring global security, industrialized countries recognized that they must work in "close cooperation with the government of developing countries" (Abidemi) in order to secure that global security and prosperity. That cooperation meant systemic aid.

Thomas Birkland, a political scientist specializing in the study of public policy, authored a book titled *Lessons of Disaster: Policy Change after Catastrophic Events*. In it, he argues that there can also be policy change without policy learning; that when confronted with a new problem, policy makers may choose, consciously or not, to take existing ideas and policies that worked in another arena and apply them to this new problem, (Birkland). That is precisely what policy makers did when presented with the new challenge of alleviating poverty and encouraging economic growth in Africa. They took the Marshall Plan, which had been a roaring success in Europe, and simply applied it elsewhere. Thus, following that logic, the answer to Africa's problem was aid and more aid.

"Africa was ripe for aid," (Moyo, 13). It has a mostly uneducated population and low average salaries, coupled with an essentially non-existent tax base, limited access to global markets, and infrastructure that left a lot to be desired, (Moyo, 13). Thus, "armed with the ideas and experience of the Marshall Plan, richer countries saw Africa as a prime target for aid," and therefore aid was given, (Moyo, 13). The belief that the Marshall Plan's implementation into Africa was a success remains largely unquestioned, however the data and facts are not quite as clear cut.

Africa was a vastly different case than that of Europe; a factor which no one seemed to take into account. In Europe, there was already an existing political, economic, and physical infrastructure. Therefore, all Europe needed was an injection of cash to get it up and running again after 1945. It was a matter of reconstruction, not construction. Africa, on the other hand, was essentially undeveloped, and "building, rather than rebuilding, political and social institutions requires much more than just cash," (Moyo, 27). Regardless, systemic aid, in the form of cash, came to Africa.

There are three ways in which donors control the aid they give to developing countries. First, donors tie the aid to procurement. As in, the aid funds have to be spent on donor-chosen goods and services from the donor itself or from a group selected by the donor. Secondly, donors can preselect the sector and/or project where the aid would be used. Third, the aid would only be provided as long as the recipient country agrees to the donor-set economic and political policies, (Moyo, 38-39). In theory, those conditionalities and checks and balances would do a great service to the recipient, but such is not the case in reality. In reality, these previously-set conditionalities are blatantly ignored. Nevertheless, massive amounts of aid funds continue to be flow to Africa, even where these conditionalities are openly violated~~,~~ (Moyo, 39). These unchecked and unregulated funds are exactly what does more harm than good in African countries: "an influx of billions of dollars of aid, unchecked and unregulated, will actually have helped to undermine the establishment of such institutions - and sustainable longer-term growth," (Moyo, 37).

Even those who are most in favor of the aid model have admitted that unchecked, unregulated, unconstrained aid flows are vulnerable to corruption rather than investment, or "of going into private pockets, instead of the public purse," (Moyo, 46). This happens often, yet no real punishments, sanctions, or consequences are ever imposed, thus "more grants mean more graft," (Moyo, 46).

The final point in how the Marshall Plan worked in Europe is vastly different from how aid was conceived and applied to Africa. In Europe, the Marshall Plan was targeted towards physical infrastructure on a set, specific timeline; it was finite. The United States asked the European countries what exactly they needed and set a goal. When the recipient countries agreed to the terms, aid came. This aid flowed for four years and then stopped, ("History…"). In contrast, Africa has continually received aid for over fifty years, ("Development…"). Further, whereas in Europe aid was specifically targeted towards physical infrastructure and never made up more than 3% of a nation's GDP, aid to Africa is more than 15% of a nation's GDP and "permeates virtually every aspect of the economy," (Moyo, 36-37). Aid is in civil service, political institutions, the military, healthcare, education, and infrastructure, to name a few, “aid is endemic… (and) the more it infiltrates, the more it erodes, the greater the culture of aid-dependency,” (Moyo, 37).

Poverty in Africa is widespread, and micro-finance is seen as a key development tool, (Van Rooyan). The idea is that by enabling the poor to use financial services, entrepreneurs have the opportunity to, for example, invest, acquire productive assets, increase their skill levels, and open new businesses, (Van Rooyan), all of which should stimulate the economy and employ a multiplier effect. However, in reality this remains a challenge, and has yet to prove itself to be a successful measure, regardless of its potential.

Problem Statement & Objective of Research:

The objective of the research for this paper is to discover which of the two forms of aid, social impact micro-finance and foreign government aid through fiscal stimulus packages, is most beneficial and most efficient in poverty alleviation in Nigeria. I am looking to find out if they work, and if not, why not, and then further, how can we improve them to make them work.

In theory, social-impact micro-finance sounds like a fantastic way to alleviate poverty in third world countries. However, it does not seem to work in reality. In fact, it has been asserted that “the success stories are comparatively few compared to the overall number of borrowers,” (Microcredit…).

As previously stated, the results are partial and contested. In one comprehensive study of microcredit in Bangladesh, nearly 10 million people were found to have risen above the poverty level, (Microcredit…). However in another done by Dr. QaziKholiquzzaman Ahmad, the chairman of PKSF which is an organization which loans money to microcredit agencies in Bangladesh, he found that only 7% of micro-finance borrowers were able to rise above the poverty line,” (Microcredit…).“Many borrowers remained where they were, while others suffered setbacks… we cannot conclude that a whole lot has been achieved,” (Microcredit).

The setbacks that borrowers suffered were numerous. Many borrowers take out loans to pay off other loans and therefore end up with multiple loans, which lands them seriously in debt. There have even been cases recorded of borrowers committing suicide due to the hopeless situation of having so much debt, (Microcredit…). With interest rates often exceeding 100 percent, “it is not hard to see how microcredit can progressively increase rather than decrease poverty,” (Sinclair).

Corruption is also a problem; “corruption is a cankerworm that has wrecked-havoc in many sectors of the Nigerian economy,” (Ikechukwu). The corruption includes, but is not limited to, the micro-finance sub-sector of the economy, (Ikechukwu). For example, there are charges against microfinance staff for coercive collection practices, (Microcredit…). Further, “frauds and forgeries by both insiders and outsiders to the banks are rife,” (Ikechukwu).

Microfinance, as it stands, does not work. David Roodman at the Center for Global Development “summarized its impact most succinctly: ‘zero’,” (Sinclair).

The alternative to social-impact micro-finance is foreign government fiscal stimulus packages in aid, or, more simply put, systemic aid. More than US $1 trillion in development assistance has come to Africa over the last several decades, (Moyo, xix). The rate, and amount, of aid has increased over the years, yet “despite the increased foreign assistance to Nigeria, macroeconomic performance has remained weak, (OECD, 2007),” (Abidemi). According to a World Bank report of fiscal activities in Nigeria from 1999-2007, there were improvements in Nigeria’s economic performance and outlook *relative to that of the two decades prior*, but that during that same time period “Nigeria’s social indicators deteriorated steadily and the country acquired one of the world’s worst reputations for corruption and poor governance,” (World Bank).

Aid hasnot worked, or helped, at all. In fact, even as Nigeria’s economy has grown, it has been accompanied by a higher rate of the population living in poverty, (“Poverty…”) (The World

Factbook).Instead of achieving its goal of alleviating poverty, aid has made the poor even more poor. The theory that aid will alleviate systemic poverty "is a myth," (Moyo, xix). "The problem is that is not benign – it's malignant. No longer part of the potential solution, it's part of the problem – in fact aid *is* the problem," (Moyo, 47).

Research Methodology Conceptual Study Framework:

This paper utilizes qualitative data taken from web-based search engine findings, data from various government agencies, peer-reviewed papers from various databases, as well as published books. The sources used in this paper cite both qualitative and quantitative data taken from interviews, studies, and further research.

To the best of my knowledge, no one has compared these two types of aid and their individual impacts and shortcomings in Nigeria specifically until now.

Data Collection & Data Analysis:

There are multiple problems with social-impact micro-finance, i.e. charity based aid, as well as with systemic, whether bilateral or multilateral, aid, and with how they are implemented.

Social-impact micro-finance organizations such as Kiva and Microplace, as previous explained, are mission-oriented not-for-profit websites that connect lenders with borrowers around the world. These non-profits enlist the help of local microfinance banks in whichever area the borrowers are. While analysts recognize that these non-profits like Kiva are well-meaning, many have questioned whether or not they have "sufficiently vetted the organizations (local microfinance banks) they promoted," (Macfarquhar).

Muhammad Yunus, who was awarded the Nobel Peace Prize for pioneering the concepts of microcredit and microfinance, listed at least "seven fundamental flaws" with microfinance banking in Nigeria, (Komolafe). First, Yunus asserts that in Nigeria, social impact microfinance is not geared for the poor or the poorest poor. Instead, it is directed at traders, suppliers, and importers, which explains the "cut throat interest rates" that Nigerian microfinance banks charge, (Komolafe).

Secondly, as a result of Nigeria gearing these banks towards commerce, they are mostly located in urban areas, as opposed to rural ones, (Komolafe). As over 53% of the Nigerian population lives in rural areas, (Rural Population), the location of the banks alone hinder the ability to aid the poor. Consequently, the location of these microfinance institutions misses the entire point of social impact microfinance.

Thirdly, and another way that the microfinance institutions in Nigeria miss the point, these banks insist on obtaining collateral for their loans; they do not lend to start a new business. According to Yunus, this "is *not* microfinance," (Komolafe). Along those same lines, and fourth, microfinance banking was founded to be women oriented and focused. Yunus said, "Conventional banks go to the men, we went to the women," (Komolafe). This is not the case in Nigeria. Nigerian banks focus on whoever can pay their astronomical interest rates and again, they have missed the point, (Komolafe).

Fifth, as epitomized by Yunus' quote regarding his first microfinance bank, "conventional banks are owned by rich men, Grameen Bank is owned by poor women," (Komolafe). Nigerian microfinance banks are owned and regulated by wealthy Nigerian men who are looking to make a profit off of their poor customers, (Komolafe). Once again, Nigerian microfinance banks miss the point.

The sixth of the seven fundamental flaws in Nigerian microfinance is that the microfinance banks are allowed to charge *any* interest rate they choose, (Komolafe). Hence, Nigeria has the skyrocketing interest rates that are upwards of 140%, (O'Neil). Conversely, Grameen Bank capped their interest rates at a 10% margin between the cost of funds and the interest rate, (Komolafe). According to Yunus, the highest interest rate ever charged was for income yielding activities at 20% simple interest, but for a housing loan they would only charge 8% simple interest, (Komolafe).

Yunus and Grameen Bank achieved these lower interest rates by doing whatever they could to keep their costs down. On the other hand, micro-finance banks in Nigeria have an inordinate tendency to copy, mimic, and compete with large commercial banks. Many microfinance managers and staff come from a background of commercial banking, therefore they believe microfinance is "just an extension of the commercial banking they know," (Ikechukwu). They come with their "organizational orientation, philosophy and culture… (and) refuse to understand microfinance is not micro-commercial banking," but a different type that requires different approaches, different philosophies, and has a different client base, (Ikechukwu). Consequently, many microfinance banks "spend colossal sums on office complex, exotic cars and the wardrobe of their staff," (Ikechukwu).

These practices are exactly opposite of what Yunus intended microfinance to be. Grameen Bank, for example, operated under an entirely different mindset: "we believe that people should not go to banks, rather banks should go to people," (Komolafe). Yunus made sure that they visited every customer at least once a week, so there was no need for expansive offices. This helped Grameen Bank reduce its running cost immensely, (Komolafe).

The greatest flaw with microfinance banking in Nigeria is that these banks, organizations, and institutions are profit-driven, rather than charity-based and mission-driven. Yunus founded microfinance as a solution for poverty alleviation, "microfinance is a social business; it is not for profit but to help people out of poverty… poverty is the fault of the society, the individual is just a victim of poverty," (Komolafe). Yet as it stands currently, the promoters for these microfinance organizations saw microfinance as "cheap access to owning a bank and making money," (Komolafe) so they set profit targets for their staff and management, and engage in many other 'for-profit' practices.

Social-impact microfinance organizations are charities, and their mission statement and premise of operation should reflect as much. Mr. Waterfield of mftransparency.org poised the question "you can make money from the poorest people in the world – is that a bad thing, or is that just a business?" (Macfarquhar). CARE, an Atlanta-based humanitarian non-profit focused on social-impact micro-finance, was bought by one of Peru's largest banks, Banco de Credito, to the tune of US $96 million. Of that, CARE executives pocketed US $74 million, (Macfarquhar). While this is not illegal, it is unethical. The reality is that these social-impact microfinance institutions are not for-profit businesses, but not-for-profit charity-based organizations.

Organizations like CARE are able to rake in such enormous profits as a result of their business practices. Interest rates in Nigeria alone are often over 140%, and "their [the microfinance institutions'] astronomical interest rates made it impossible for their customers to benefit at all," (O'Neil). This leads to a serious over-indebted problem among borrowers, where borrowers are taking out loans to cover prior loans and even ending their lives to get out of the endless debt piling up on them, (Microcredit…). When people are committing suicide because of the serious debt they have incurred, especially from loans that were geared to help them get out of poverty, there is a problem. The increasing commercialization of the industry has been met with "concerns around the ethics of making money from the poor," as well as concerns about "mission drift," (Van Rooyan). As Mr. Waterfield asks, "at what point do we say we have gone too far?" (Macfarquhar).

Hugh Sinclair whistle-blew on one microfinance firm in Nigeria, LAPO, after he was tasked with redoing their IT system. He was given all of their data, and was "disgusted by the way LAPO treated its customers," (O'Neil). Sinclair cited many examples of practices like the microfinance firm forcing customers to put a 20% deposit down but still charging interest on the entire loan, purposefully miscalculating interest rates, and using deposits for further loans. This was all done legally, although unethically, by making the customer sign a form that the customer did not understand, (O'Neil).

While charity aid is considered "small beer" when compared to the hundreds of billions in government-to-government transfers, (Moyo, 8), the microfinance industry currently has over US$60 billion in assets, and thus has "unquestionably outgrown its charitable roots," (Macfarquhar). This speaks to assertion of mission drift and unethical behavior and practices. Analysts say that the overriding question facing the industry is still "how much money should investors make from lending to poor people, mostly women, often at interest rates that are hidden," (Macfarquhar).

Yunus asks microfinance institutions to "remember where microfinance came from; it is banking for the poor," (Komolafe).

Further, there are "weak laws and little to no enforcement" (O'Neil) in the Nigerian government's regulation of microfinance, or of systemic, government-to-government, aid either. The immense sums of aid transferred to Nigeria not only fosters corruption, but is an impetus for corruption, (Moyo, 52).

> "If the world has one picture of African statesmen, it is one of rank corruption on a stupendous scale. There hardly seem any leaders who haven't crowned themselves in gold, seized land, handed over state business to relatives and friends, diverted billions to foreign bank accounts, and generally treated their countries as giant personalized cash dispensers," (Moyo, 48)

To list all of the corrupt practices found in Africa would be a much longer list, but the point is not that corruption exists; the point is that "aid is one of its greatest aides," (Moyo, 48). Aid nourishes corruption that fosters more corruption. Foreign governments give, or loan, aid funds that uphold the corrupt government, which provides those government officials with essentially free cash, to do with as they please. Yes, donor countries have the three methods previously mentioned in which they control the aid dollars, but that is a technicality at best. As also previously mentioned, those conditionalities are more often than not blatantly ignored, and the donor countries do not enforce any real punishment or consequence. Rather, they just continue with ever greater sums of aid.

This vicious, downward-spiraling cycle that aid has created "chokes off desperately needed investment, instils a culture of dependency, and facilitates rampant and systematic corruption, all with deleterious consequences for growth," (Moyo, 49). Further, it actually perpetuates underdevelopment and economic failure.

The extreme amount of corruption that runs rampant through Africa at large, and Nigeria specifically, is a large deterrent of investors. With the high degree of corruption, and therefore uncertainty, fewer domestic *or* foreign entrepreneurs are willing to risk their money investing into businesses where corrupt officials can simply claim their proceeds. Consequently investment stagnates, and falling investment destroys economic growth, (Moyo, 50). In fact, in May 2004 the United States Senate Committee on Foreign Relations held a hearing at which experts asserted that the World Bank has "participated (most passively) in the corruption of roughly US $100 billion of its loan funds intended for development," ("Hearing on…). Others estimate that the figure is at least at US $130 billion. Further, when loans from other multilateral-development banks are also taken into account, those figures more than double, ("Hearing on…").

Yet despite this corrupt environment, everyone still continues to lend, (Moyo, 23). Further, donors, development agencies, and policymakers chose to ignore the blatant alarm signals, and instead chose to pursue the aid-based model, (Moyo, 27). Regardless of the motivation behind aid-giving – whether economic, political, or moral – aid has "failed to deliver the promise of sustainable economic growth and poverty reduction," (Moyo, 28); aid has "not translated into a significant decline in poverty levels… over 62% of Nigeria's 170 million people still live in *extreme* poverty," (World Factbook).

Findings and Recommendation:

The reality is neither types of aid, whether social-impact micro-finance or systemic, have helped alleviate poverty in Nigeria. They do not work mainly because there are a lot of issues in the way in which the aid is provided and implemented.

Systemic aid does not work. Yet many donors decide still to lend to "less than reputable governments" because they believe that if they did not, "the poor would suffer, health and education budgets wouldn't be met, and countries would falter," (Moyo, 54-55). Therefore, the decision to continue to lend is like picking the lesser of two evils. However, in reality the poor are still not getting the money and the countries are faltering anyway. It is, at the end of the day, "virtually impossible" to look at the aid-led development experience in Nigeria and the rest of Africa and argue that aid has worked, "the broadest consequences of the aid model have been ruinous," (Moyo, 27).

On the other side of that same token, social-impact micro-finance does not currently work either. The difference is that social-impact micro-finance *could* work. Yes, changes would have to be made and adhered to, but if they came to pass, it would work.

In order to improve social impact micro-finance so it functions at its maximum efficiency and impact, micro-finance institutions must implement some difficult but necessary changes. To start with, the primary motivator for these institutions is to alleviate poverty in depressed economies; it is not to make a profit. The previously mentioned non-profit CARE that sold for US $96 million, $74 million in profit, confuses this primary purpose, and should not continue to happen. However, there is an "inherent conflict of interest between making profitable loans and helping the poor, and greed nearly always wins," (O'Neil), thus this may require some sort regulation that sets a cap on potential profit margins. The cap would have to be high enough that it still incentivizes investors, yet low enough that it does not take away from the primary objective. Mr. Yunus says that "you will never see the situation of poor people if you look at it through the glasses of profit-making," (Macfarquhar). As long as these institutions keep that objective in mind, changes can be made to make this system work.

Secondly, the local micro-finance lenders need to implement a credit-score rating system on the borrowers similar to that which first world countries employ. Every borrower should originally be given the benefit of the doubt, but their credit score would increase or decrease depending on their performance. This rating system would (a) enable lenders to determine whether or not to give whichever borrower more loans in the future, and (b) disable a borrower's ability to become "over-indebted."

Thirdly, the Social-Impact Micro-Finance institutions need to place a much lower cap on interest rates. As it stands, the current high interest rates lead to borrowers taking out loans to pay off other loans, extreme over-indebtedness, which then leads businesses to failure and borrowers to such extremes as suicide. According to Mr. Yunus, interest rates should be capped to 10-15% above the cost of raising the money. Anything beyond falls into a "red zone" of loan sharking, "we need to draw a line between genuine and abuse," (Macfarquhar). To achieve the institutions' missions of alleviating poverty in depressed economies, these loans need to be repayable for the borrowers. Therefore, a low cap, between 10 and 15%, must be placed on interest rates.

Finally, and probably most importantly, the overarching social-impact micro-finance institutions need to be sure to provide serious oversight on the local micro-finance lenders that they work with, "the case for greater regulation has been voiced clearer and louder as businesses have failed and suicide rates risen," (Van Rooyan). Without their strict oversight and regulation of these lenders, very little positive impact will occur.

Scholars are unanimous in their agreement that there exists a large untapped market for microfinance banks, (Ikechukwu). In fact, microfinance banks in Nigeria only serve less than one million out of the over 40 million people that require their services, (Ikechukwu), so there is a lot of room for the micro-finance industry to grow.

As previously established, billions more are given in systemic aid than in micro-finance. However, if the same amount of aid was given to each, and the micro-finance industry made its necessary changes, the micro-finance model would be much more successful.

Conclusion:

The two types of aid, systemic aid and social-impact micro-finance that have been examined in this paper are flawed. Yet, if the necessary changes are made and adhered to, and the aid is financed to the same extent, social-impact micro-finance proves to be superior, "the social-impact micro-finance process is sound, as long as the loaning agent does their due diligence," (Jacobsen). Social-impact micro-finance is "highly imperfect, but it's like a 3 1/2-year-old child: it has a lot of potential," (Strom).

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