Informal Sector Microfinancing for Poverty Alleviation in Namibia

Jing Xie
Princeton University

Abstract

The relationship between poverty and informal labor has been the focal point of many literatures. Several literatures studied the one-directional relationship from poverty or informality . The result found that a low standard of living and low exposure to formal sector employment under poverty forced households into the informal sector. On the other hand, the economic conditions associated with informality, such as low wages and low skills, lower individual's prospects and strip their chance into the formal sector. Contrary to the one-direction studies, Bolarinwa and Simatele (2022) investigated the simultaneous and dynamic framework between informality and poverty. Using data from forty sub-Saharan African countries, they concluded a bilateral causal relationship between these two factors, and the relationship seems to hinge on income level. Consequently, they suggested governments in the region focus on improving the access to resources to allow poor informal sectors to start or maintain basic income and thus achieve poverty reduction.

One of the most significant challenges facing informal sector laborers is the access to financial resources. Some poor people in the informal sector may have entrepreneurial ideas to start a business, need stable funding to maintain their vendor businesses, or need emergency money for health or education-related expenses. However, most formal banks will reject their funding request due to a lack of collateral and high default risks.

In this paper, I will provide recommendations to three questions of interest in tackling the financial resources access challenges that poor informal sectors face to achieve the poverty alleviation goal further. First, what non-African country's experience is most relevant to an African situation? Second, what policies/programs seemed to have worked well elsewhere? Third, can these policies be pursued in Namibia? If so, what might be the potential obstacles during implementation? Lastly, I will end with my policy recommendations.

1.Introduction

In the capital city of Namibia, a group of female street vendors are setting up their merchandise (ranging from tribal handcrafts to local souvenirs) under a cluster of shabby umbrellas. Among them, a middle-aged woman with three children anxiously touts to pass-by visitors to purchase. Like many others, she relied on daily wages for her family's living expenses. As COVID-19 hit the world, Namibia closed its borders and "shut down" the country. Suddenly, she lost all her income. Because she was an unregistered laborer, she couldn't receive any government unemployment benefits. Throughout the two years of lockdown, her family relied solely on free food distributed by local charity organizations. As the country reopens, charity support stopped, but visitors are still incomparable to the pre-pandemic level. Unfortunately, this woman and her family now suffered from double strikes of hunger and poverty.

I met this Namibian lady and her family during an IMF mission travel in August 2022. During our meeting with the deputy governor of the Bank of Namibia, we learned that the informal sector accounts for almost seventy percent of the country's employment and that the government recognized the important dynamics between the informal sector and poverty. Therefore, to reach the poverty alleviation goal proposed in the "Harambee Prosperity Plan II of 2021-2025 [United Nations, 2021; https://www.un.org/annualreport/2021/index.html]", the government is planning to shift towards formalizing the informal economy through a series of initiatives such as multi-stakeholder workshops on the national diagnostic of informality and national employment plan [https://namibia.un.org/en/245839-namibia-takes-bold-step-towards-formalizing-informal-economy]. Although the actual effectiveness of these initiatives is still yet to be evaluated, the extent to which the Namibian government prioritizes the informal sector in poverty alleviation is a hopeful starting point.

The relationship between poverty and informal labor has been the focal point of many literatures. Several literatures studied the one-directional relationship from poverty or informality [Canelas, 2019, Devicienti et al., 2010; Dell'Anno & Solomon, 2008; Kanbur, 2016; 2024]. The result found that a low standard of living and low exposure to formal sector employment under poverty forced households into the informal sector. On the other hand, the economic conditions associated with informality, such as low wages and low skills, lower individual's prospects and strip their chance into the formal sector. Contrary to the one-direction studies, Bolarinwa and Simatele [2022, https://onlinelibrary.wiley.com/doi/full/10.1002/sd.2468] investigated the simultaneous and dynamic framework between informality and poverty. Using data from forty sub-Saharan African countries, they concluded a bilateral causal relationship between these two factors, and the relationship seems to hinge on income level. Consequently, they suggested governments in the region focus on improving the access to resources to allow poor informal sectors to start or maintain basic income and thus achieve poverty reduction.

One of the most significant challenges facing informal sector laborers is the access to financial resources. Some poor people in the informal sector may have entrepreneurial ideas to start a business, need stable funding to maintain their vendor businesses, or need emergency money for health or education-related expenses. However, most formal banks will reject their funding request due to a lack of collateral and high default risks. As a result, most poor chose to borrow from informal sources, such as local moneylenders with incredibly high-interest rates. In most cases, the interest burden is higher for the extremely poor than for the less poor. For example, in Udaipur, India, those living less than 99 cents a day pay an average of 3.84 percent per month, equivalent to an annual rate of 57 percent. Those between 99 cents and 2 dollars per day pay only 3.13 a month in interest. The differential interest rate is mainly because the poor rely more on informal than formal funding sources, which is more expensive [Abhijit v. Banerjee & Esther Duflo, 2022]. Without stable access to credit, the poor in the informal sector are usually overburdened by immediate interest payments, keeping them in the endless poverty trap. Because they need to spend their urgent earnings on high-interest payments, they cannot accumulate savings to acquire equipment or services to help enhance their productivity and improve incomes. Neither do they have savings for any emergency needs. When unexpected events occur, they don't have savings to fulfill their financial needs, and they need to borrow further. The vicious circle continues.

In this paper, I will provide recommendations to three questions of interest in tackling the financial resources access challenges that poor informal sectors face to achieve the poverty alleviation goal further. First, what non-African country's experience is most relevant to an African situation? Second, what policies/programs seemed to have worked well elsewhere? Third, can these policies be pursued in Namibia? If so, what might be the potential obstacles during implementation? Lastly, I will end with my policy recommendations.

2. What non-African country's experience is most relevant to Namibia's situation?

When talking about the informal sector, India is usually the first country to come up, as more than eighty percent of the Indian workforce engages with informal sectors [Hammer et al, 2022]. Comparing India with Namibia, they both have similar economic growth rates in recent years (India grew by 7.2 percent in 2022, and Namibia grew by 7.6 percent) [World Bank National Accounts Data; https://data.worldbank.org/]. Both countries are democracies and received comparable Democracy Index in Egalitarian, Electoral, Liberal, and Participatory dimensions in 2022 by V-Dem [https://www.v-dem.net/]. Additionally, the poverty levels of the two countries are similar. The latest poverty headcount ratio at $2.15 a day (% of the population) is 18.7 percent in India and 15.6 percent in Namibia [World Bank National Accounts Data; https://data.worldbank.org/].

Despite all the similarities, the multidimensional poverty index (MPI) from the United Nations reported a drastically different picture for India and Namibia. The estimated multidimensional poverty in India is 16.4% of the population, whereas the figure is 43 percent in Namibia [https://ophi.org.uk/global-mpi]. The MPI measures interconnected deprivation across indicators related to health, education, and living standards and MPI has been regarded as a more accurate depiction of the poor's living conditions than the monetary index. The similarities in economic growth, monetary poverty, and political regimes between India and Namibia and the dissimilarity in multi-dimensional poverty provide an opportunity for Namibia to learn from India in efforts to reach poverty alleviation goal.

3. What policies/programs seemed to have worked well to alleviate poverty in India in tackling access to financial services for poor informal sectors?

The Indian government is aware of the challenges that poor informal workers face in accessing financial resources and has tried several approaches to tackle these difficulties (such as constraints in physical access, high rejection rate, and high-interest rate). For example, starting in 1977, the Indian government required banks to open four additional branches in rural locations for every branch that a bank opened in a city. Additionally, banks had to allocate at least 40 percent of their portfolios to the "priority sector," including small firms, agriculture, cooperatives, and the like. Although scholars showed that poverty decreased faster when more bank branches opened because of this policy, this policy faced multiple problems involving high default rates and corruption. The failure indicates that the government may not be the right venue to subsidize lending [Banerjee, A.V.& Duflo, E., 2022].

Following the realization of involving private bankers in the solution, India followed Bangladesh economist Mohammed Yunus in introducing microfinance. Microfinance fulfilled the dual missions of profitability and social responsibilities. On the one hand, Dr. Yunus was awarded the Nobel Prize for Peace for his contributions through Grameen Bank. On the other hand, the Initial Public Offering (IPO) of multiple microfinance institutions (MFIs) worldwide is a commercial triumph. Unlike traditional informal moneylenders, MFIs involve other borrowers who happen to know the customers to ensure the repayments. Instead of physical threats, MFIs utilize the power of shame to maintain a low default rate. MFIs also remove all flexibility from traditional money lending, and they require borrowers to repay a fixed amount every week, starting one week after the loan is given out. All these innovations contribute to low administrative costs and low default rates, thus reducing the interest rate applied to customers [Banerjee, A.V.& Duflo, E., 2022].

One of the largest MFIs in India is Spandana Sphoorty, created in 1998, to provide micro-loans specifically for women borrowers and uplift lives of rural households and communities. As of 2023, they have more than 1500 branches spreading to 19 states, covering 2.7 million borrowers with 97.8 billion rupees [Banerjee, A.V.& Duflo, E., 2022]. The J-PAL (Poverty Action Lab) evaluated the impacts of microfinance when Spandana expanded into some areas of the city of Hyderabad. Of 104 neighborhoods, 52 were chosen randomly for Spandana to enter. 15 to 18 months after Spandana started lending, J-PAL found clear evidence that Microfinance was working; more specifically, people in the neighborhood with Spandana access are more likely to have started a business and purchased large, durable goods. There is no clear evidence of the reckless spending that some observers feared would happen. They concluded that microcredit has earned its place as one of the key instruments in the fight against poverty [https://www.povertyactionlab.org/evaluation/measuring-impact-microfinance-hyderabad-india].

4. Can Microfinance be pursued in Namibia? If so, what might be the potential obstacles during implementation?

Many studies of the impact of microfinance on poverty alleviation are explicitly conducted in the sub-Saharan Africa region. Evidence has shown that Africa's relatively slow economic growth has been linked to its poor capital accumulation. The average savings as percentage of GDP in the region is 18.81 percent, while Namibia has the lowest value with 3.38 percent [www.worldbank.org/ext/en/home]. Low savings rates and capital accumulations led to high demand for financial resources. However, as mentioned earlier, access to financial resources is minimal for poor people working in the informal sector, due to high default rates, lack of physical access, and high interest rates. Therefore, microfinance is an essential tool in Namibia's poverty eradication mission.

The United Nations analysis presents both material and non-material benefits of implementing microfinance to poverty alleviation. For material benefits, the MFIs can help people become more economically secure and enhance basic household welfare through a multiplier effect on people's standards of living. Meanwhile, MFIs can liberate low-income households from moneylenders with outrageous interest rates and free them to start or improve their small businesses, providing income generation and employment. For non-material benefits, financial security can also bring positive social and psychological effects, empowering individuals to further realize their potentials [Microfinance in Africa, www.un.org/africarenewal/sites/www.un.org.africarenewal/files/Microfinance.pdf].

One of the largest criticisms of implementing microfinance in the sub-Saharan Africa region is that MFIs in Africa usually suffer from structural weaknesses and lack the capacity to meet the needs of the poor. Their support services are often of uneven quality and the supervisory and coordinating sections often have very limited resources. To tackle this obstacle, governments must play a fundamental role in consolidating and sustaining the microfinance sector with appropriate policies and regulatory frameworks [United Nations, Combating Poverty and Inequality, (2010), www.un.org/esa/ecesa/documents/documents/policy_briefs/ecesa_pb_1.pdf]. Namibia could reference the regulatory framework for microfinance loans proposed by the Reserve Bank of India, which provides essential guidance on items related to loans for consumption, collateral requirements, and insurance. These governments' involvement can ensure market discipline while providing confidence to borrowers.

Additionally, critics of MFIs often cite the lack of long-term critical transformation of microfinance, especially that women didn't feel more empowered in households despite the additional granted to them and that MFIs discourage longer-term business ideas due to the urgency to start repayment. To tackle these legitimate doubts, the Namibian government needs to encourage MFIs to propose innovative ideas to adjust the traditional microfinance loans, especially in adding flexibility in extended repayments for solid and longer-term needs. Meanwhile, the government needs to complement microfinance with other poverty alleviation programs to transfer the efforts into more sustainable efforts in reducing poverty, such as human capital formation, welfare provision, and direct poverty alleviation.

5. Conclusion and Policy Recommendations

This paper discusses the relationship between the informal sector and poverty alleviation, especially in the context of sub-Saharan Africa and Namibia. The latest literature presents dynamic and mutual influences between these two variables and recommends that the government improve access to essential resources to allow poor informal sectors to maintain or improve basic income and thus reduce poverty. Access to financial resources is one of the largest challenges faced by poor people in the informal sector, due to overburdened interest payments and lack of physical access. Microfinance has been proposed as a solution to improve financial access for poor informal workers. India, as a comparable country to Namibia, has shown a successful implementation of Microfinance.

Despite capacity obstacles faced in the region, the Namibian government should encourage the expansion of Microfinance branches into both rural and urban regions with subsidies or tax credits as incentives. Meanwhile, the government needs to propose a regulatory framework to discipline the industry and add confidence to borrowers. Lastly, I recommend the government to complement the expansion of Microfinance with other poverty alleviation policies/programs, such as direct cash transfer and human capital formulation, to reach a more sustainable poverty reduction goal.

References

Banerjee, A.V.& Duflo, E., (2022), Chapter 7, Growth Theory through the Lens of Development Economics, Harvard University Press, Belknap Press, pp 158-159, www.jstor.org/stable/j.ctv3006zpt, update: September, 2024.

Canelas, C., (2019), Informality and poverty in Ecuador, Informality and poverty in Ecuador, Small Business Economics, Springer, vol. 53(4), pages 1097-1115.

Dell'Anno R. & Solomon H., (2008), Shadow economy and unemployment rate in USA: is there a structural relationship? An empirical analysis, Applied Economics, Vol. 40, Iss. 19, pp. 2537-2555.

Devicienti F., Strigari L., D'Andrea M., Benessi M., Dimiccoli V., and Portalur M., (2010), Patient positioning in the proton radiotherapy era Studies on the effect of poverty on informality, Journal of Experimental & Clinical Cancer Research, pp. 29:47.

Hammer, A., Keles, J.Y., Olsen, W., (2022), Working Lives in India: Current Insights and Future Directions, Work, Employment and Society 36(6), pp. 1139-1154.

https://data.worldbank.org, update: September, 2024.

https://documents1.worldbank.org/curated/en/099056007072227384/text/IDU0944e7277054e1047800a2e10cc7e32c805e4.txt, update: September, 2024.

https://ophi.org.uk/global-mpi, update: September, 2024.

https://pip.worldbank.org/home, update: September, 2024.

Informality and poverty in Africa: which comes first?; https://onlinelibrary.wiley.com/doi/full/10.1002/sd.2468, update: September, 2024.

Kanbur R., (2017), Informality: Causes, consequences and policy responses, Review of Development Economics, Vol. 21, Iss 4, pp. 939-961.

Kanbur R., Stiglitz, J.E., (2016), Dynastic inequality, mobility and equality of opportunity, The Journal of Economic Inequality, pp. 439-434.

Microfinance in Africa, www.un.org/africarenewal, update: September, 2024.

Namibia Takes a Bold Step Towards Formalizing the Informal Economy; https://namibia.un.org/en/245839-namibia-takes-bold-step-towards-formalizing-informal-economy; update: September, 2024.

United Nations, (2021), https://www.un.org/annualreport/2021/index.html: update: September, 2024.

United Nations, Combating Poverty and Inequality, (2010), www.un.org/esa/ecesa/documents/documents/policy_briefs/ecesa_pb_1.pdf, update: September, 2024.

www.povertyactionlab.org/evaluation/measuring-impact-microfinance-hyderabad-india

www.un.org/annualreport/2021/index.html, update: September, 2024.

www.v-dem.net, update: September, 2024.