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# Lex:lead Group annual scholarship competition **2012**

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## 2012

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# Lex:lead Group annual scholarship competition: summary

**T**he following articles were winning submissions in the 2012 Lex:lead Group annual scholarship competition. Winners were decided by a panel of international judges, lawyers and academics, judged independently. Awards are funded by a grant to the Lex:lead Group from the International Bar Association Foundation. For more information, please visit [www.lex-lead.org](http://www.lex-lead.org).

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## IBA Foundation

**T**he International Bar Association Foundation is a United States-based charitable foundation, established in 1986 by members of the IBA to engage in educational and charitable activities related to advancing the rule of law.

While the Foundation has worked closely with the IBA over the last 30 years, it has operated as a separate and independent entity with a historical mandate that has allowed it

to support a broad range of rule-of-law-related undertakings.

To find out more about the IBA Foundation, visit [www.ibanet.org/About\\_the\\_IBA/IBA-foundation-inc.aspx](http://www.ibanet.org/About_the_IBA/IBA-foundation-inc.aspx). On our webpage, you will find information about the Foundation, its mission, its officers and trustees, and some of the activities it has recently funded.

# How can law enhance access to finance in developing countries to reduce poverty?

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In developing countries, where poverty is the order of the day for a great part of the population, the means of earning a living are limited. Employment rates are low, but engaging in enterprise can be beyond reach for reasons of financial shortage, among others.

Even the employed often do not make progress, as many support not only themselves but also family members – immediate and extended – with whom they share the small amount they earn. Although this sustains the lives of those supported, it is not an escape from poverty. The money earned is used solely for subsistence without margin for savings or investments.

Lack of employment is often due, among other reasons, to low education levels and limited opportunities in the country's economy. Nonetheless, the unemployed have the potential to contribute productively to society. With improved access to appropriate levels of finance, more people can become self-employed and thus improve their livelihoods. An improved legal and institutional infrastructure can facilitate greater access to finance, and can support an availability of credit once established.

Instances where nations have fostered an improved financial environment exist, with impressive results. Greater access to finance has been shown to be effective in reducing poverty. One successful example is that of the increased availability of micro-finance and micro-credit that has achieved success in past decades, notably by the Grameen Bank of Bangladesh.

The aim of this article is to look into the role that law can play in making access to financial services easier, thus reducing poverty. As a strong legal framework is a necessary (though not a sole) condition to achieving any objective, framing the appropriate laws and creating a suitable legal, as well as institutional, environment is a good place to start this discussion about reducing poverty.

This article is divided into three sections:

- the current situation vis-à-vis the inability of the poor to gain access to financial services;
- a look into the potential for law to remedy the

- problem; and
- potential positive outcomes.

## The current situation as to the inability of the poor to gain access to financial services

The formal sector – particularly banks – is the best-established institution in the realm of finance. Banks are, however, largely inaccessible to the poor, who cannot, for instance, obtain loans from such sources. Although the fact that the poor are poor is a fundamental reason for their exclusion here – their lack of assets typically renders them a high credit risk for a bank engaged in the business of granting loans, coupled with the fact that the high administrative costs of managing multiple smaller loans is often not cost-effective for a bank – the reasons may also be due to a lack of legal and enforcement mechanisms, and a lack of awareness on the part of the public about available mechanisms.

Barriers to entry on the side of the applicant are severe too. The poor are often largely illiterate, or equipped with only a partial primary education, which typically does not extend to an understanding of the formal financial sector. Coupled with the inability to provide collateral for loans or fees to offset the costs of maintaining a deposit account, low levels of literacy hinder an applicant's use of such services and aggravate the fear of the sophisticated environment in which banks are typically found.

Assuming nonetheless that a large section of society wishes to make use of financial services, what can be done to extend such services to the poor? Beyond improving education levels, expanding the legal and institutional framework to improve access to finance for the poor that they can afford can help the wider economy of a country. Expanding the availability of services that don't require the posting of collateral, for instance, but look to other guarantees of repayment, such as community contracts, can be one way to improve access to finance. Improved education, specifically in the use and obligations of financial services, is another, both

to non-traditional sectors such as microfinance, as well as (in some instances) to formal banking structures.

### **A look into the law's potential to remedy the problem**

Through the implementation of law, positive change can be realised. As such, law may be structured to respond to the needs of society and to lay down a foundation for practical results. For this to be achieved, the particular problems to be solved and a path to their resolution should first be identified. We start by looking at the defining parameters of access to finance, namely that it is the extent to which people are able to gain access to and make use of financial services, including microcredits, deposits, payment services, insurance and the like. How, then, do we implement laws that improve the extent to which people are able to make use of such services?

To tackle poverty and create an environment for widespread economic development, we need laws that bring about effective change. Having access to financial services has been shown to have a positive impact in generating income and supporting one's self and one's family, thus achieving self-sufficiency. With different forms of financing possible, the lawmaker's task is also to look to the range of options and decide which may be best suited to existing conditions in the country. While some countries have had considerable recent success, for instance with mobile phone banking and transfers, in very poor, rural communities, these telephonic networks may still be beyond practical reach. Improving access to small (micro) loans, however, may be at a more accessible scale, particularly with small groups that can form enterprises and work toward a common end.

Once the issue at hand (improving access to finance), the ongoing problem (the inaccessibility of the formal sector) and the solution (expanding use of the above-mentioned alternatives) are identified, laws can be formulated in a way that address the problems and lead to solutions.

Nonetheless, laws that facilitate access to financial services cannot reduce poverty by themselves; follow-up mechanisms also need to be created to ensure their implementation and smooth out institutional hurdles that remain. Law itself should be simple, accessible and understandable, so that target groups can be aware of their rights and duties and are able to speak up when deviation from the

goals of the law is witnessed.

Law should be transparent and a system designed where officials entrusted with its implementation can be held accountable. It should be applied even-handedly to every target group. Discrimination should be avoided as it hampers both the effectiveness of the law and the aims of poverty reduction.

In addition, implementation of the law should be consistent with the country's constitutional principles, so as to avoid abuses of power, deviations from the rule of law, corruption and the like.

### **Potential positive outcomes**

With the situation assessed, solutions identified and laws drafted and implemented that are consistent with these objectives, success may be within reach. Through improved access to appropriate levels of finance, the poor may, for example, take out loans and engage in different businesses that generate sufficient money to both pay back their loans and (importantly, to my mind) improve upon their standard of living. Coupled with a legal framework, for such success to materialise, people will likely also need to be provided with basic educational training for the management of their businesses and the ways the system that is crafted for their needs can function.

By enabling the poor to gain access to financial services and to become productively self-employed, dependency rates will decrease and self-sufficiency will become viable. Families' lives will be improved. Children who were previously unable to get even free primary education (where, for instance, they had to generate all the money they could just to sustain their family) now stand a chance to attend school and the promise of a brighter future.

Heads of families, particularly women, can be empowered as they see their efforts turn from struggling to survive to actual development and changes in their lifestyle. And, as the life of many families may change, the number of poor households may decrease and a society's lifestyle change. Eventually, the lives of all poor citizens may be improved, hopefully to the point of eradicating poverty in its entirety.

Improving access to finance to achieve poverty reduction may seem far-fetched, yet prominent authors such as Muhammad Yunus disagree.<sup>1</sup> To me (and, I would suggest, to Muhammad Yunus), the essence of development is changing the quality of life of the bottom tiers of the population. And that quality is not to be defined just by the size of



the consumption basket: it must also include an enabling environment that lets individuals explore their own creative potential. This, to my mind, is more important than any mere measure of income or consumption.<sup>2</sup>

### Conclusion

To see our world with a low, possibly zero, degree of poverty is a goal shared by much of humankind. However, as we are trying to reduce poverty by half by 2015, the progress made so far is not to the desired level. I believe this is attributable to, among others factors, a lack of appropriate laws aimed at reducing poverty; the inaccessibility of adequate levels of finance to the poor; a misuse of the system; too-high levels of corruption; and instances of maladministration. But, at this juncture, once strong laws are formulated, what is left is its proper management in a manner that does not leave space for bottlenecks in poverty reduction and efforts at development.

Though formulating appropriate laws is not the only solution towards poverty reduction, it is an important step. Laws that

aim to increase access to finance should be formulated to respond to the problems of the poor by including the previously mentioned mechanisms. Once this is accomplished, the success rate of the law may increase and a well-drafted, responsive law can bring change if its implementation is further coupled with effective follow-up mechanisms.

### Notes

- 1 See Muhammad Yunus and Karl Weber, *Creating a World Without Poverty: Social Business and the Future of Capitalism* (2007).
- 2 Ibid at 56.

Ms Rediet Zegeye Yigezu is a law student at Addis Ababa University, Addis Ababa, Ethiopia. Her article was one of the highest-ranked essays in the Lex:lead Group's 2012 annual scholarship competition, as decided by a panel of international judges, lawyers and academics, judged independently. Ms Rediet Zegeye Yigezu's award was made in honour of John H Morrison OBE. For more information, please visit [www.lex-lead.org](http://www.lex-lead.org).

# How can law enhance access to finance in developing countries to reduce poverty?

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**F**inancial systems and institutions are poorly understood by many, yet their operations are taken for granted. This dichotomy is worse in developing countries, where education levels are low and access to financial institutions is, for many people, limited. Nonetheless, access to finance directly affects development. A sound structure and implementation of financial systems can increase access to finance which, in turn, can lead people out of poverty, while its denial helps to further entrench it.

International law has conferred the right to development on people. This right is inherent in international human rights instruments, such as the International Covenant on Economic, Social and Cultural Rights and the African Charter on Human and Peoples' Rights. This right to development, regardless of how controversial its implementation, at least impliedly incorporates a right of access to finance, as the two are strongly interlinked.

Empirical evidence shows that a financial system that functions well will typically lead to increased economic growth and reduced poverty.<sup>1</sup>

It may be posited that upholding this right to development is fundamental to the realisation of other socio-economic as well as civil and political rights. Taking into account that the right has been incorporated into international instruments, adopted by states (including many, least-developed countries), and upheld by international financial institutions (such as the International Monetary Fund and World Bank – each subjects of international law), each of the foregoing should take an active role in the realisation of the right to development.

With regard specifically to access to finance, a number of factors contribute to its realisation. The term refers to 'the possibility that individuals or enterprises can access financial services, including credit, deposit, payment,

insurance and other risk-management services'.<sup>2</sup>

Besides the legal framework of a country, a number of factors affect access to finance, including a country's general level of economic development and its government structure. The role of law can be significant in leveraging these attributes and increasing access. The factors are interlinked and the success of improving access to finance interdependent.

The banking system is of key importance in this arena, providing banking and other services to individuals and entities. Banks are powerful players in finance, paying interest on deposit accounts and making loans, both of which can foster growth and leverage a client's existing resources to do so. Banks are chartered and administered through legal acts, and the scope of such laws gives immense powers – and/or obligations – to banks in a country's financial system.

Factors that hinder access to finance can be broadly classified into internal and external factors. Internal factors are those that we attribute to the individual or the enterprise; external factors are those attributable to the state and other external bodies.

### **Internal factors that hinder access to finance**

#### *Documentation requirements*

Financial institutions typically require extensive documentation from an individual in order to extend loans. Notwithstanding the importance of adequate documentation for the bank's protection, when it comes to the least-developed countries, where most individuals are poor and enterprises small-scale with limited financial histories, documentation requirements can prove to be overwhelming and may be able to be simplified or assistance may be provided in navigating their terms.

#### *Cultural or religious reasons*

People may voluntarily limit themselves from using financial institutions for cultural or religious reasons.

#### *Unwillingness*

This may result from a lack of education in some parts of society, resulting in a deep mistrust of financial institutions.

#### *Lack of information or access*

Rural societies may not be aware of the existence and operations of financial

institutions, or the financial institutions may be inaccessible to them due to long distances and other economic and geographic barriers.

### **External factors that hinder access to finance**

#### *Legal impediments*

This is related to procedural hurdles that may hinder access to finance, such as fees for financial services, transaction costs, the requirements to be a beneficiary, high interest rates, the existence of discrimination and other reasons.

#### *Overarching state power*

In certain countries, states exercise great control over the activities of private enterprises and businesses. This power sometimes extends as far as the arbitrary confiscation of businesses which, in turn, de-motivates individuals or enterprises to gain access to finance and to enter into business due to the high risks posed.

### **What can law do to improve access to finance?**

#### *Incorporate traditional financial institutions into the legal framework*

Traditional financial institutions exist in developing countries and are commonly used by the poorer parts of society. These institutions may be widely accepted and preferred due to their greater availability and relative simplicity of use, among other factors. As such, incorporating these institutions into the legal framework of a country and providing them with protection, without distorting the factors that make them preferable to some segments of society, will contribute to increasing the effectiveness of financial institutions and enhance access to finance.

Incorporating these institutions into the legal framework of a country should be for more than just providing protection; it should also be directed at increasing the scale of operation of these institutions, identifying their weaknesses and finding solutions.

#### *Provide equal opportunities*

This is related to the legal framework of the country that directly and indirectly affects access to finance, through both procedural and substantive rules. The underpinnings of a country's legal system should have the rights

of individuals, and the growth and economic development of those citizens, on an equal footing, aiming at a common good. If these basic considerations are not at the heart of a legal system then, in financial systems, as with other elements, it will be difficult to ensure equal opportunity to people at later stages.

Financial institutions must not be structured in a way that the system can only operate in favour of some at the expense of the masses. From access to financial institutions, to their manner of usage, they should be able to be accessed by all without discrimination.

### *Build an all-inclusive system*

Law should help the process of opening the financial system to small enterprises and poor households. Additionally, there should be efforts from the legal side to encourage the creation of and aid the viability of small and micro institutions. Transition costs should be small and affordable by the majority. Developing mechanisms to address the high costs of small loans so that poorer members of society can have access – such as shared obligations or guarantees – can have wide-reaching benefits.

### *Be transparent*

The financial system must operate in a transparent manner and its manner of operation should be clear to all. There is a great deal that may be done in terms of awareness-creation, expanding an understanding of the use and benefits of financial institutions.

### *Provide security*

Laws should provide security and recourse for small enterprises and households from abuses by financial institutions, and from arbitrary governmental intervention.

### *Facilitate a competitive environment*

An environment based on fair and open competition will enhance productivity, increase efficiency and facilitate the flow of finance. This will aid the process of development.

## **What can international law do to improve access to finance?**

### *The role of international financial institutions*

International law can play a significant role in poverty reduction in developing countries through monitoring and controlling international financial institutions and making sure they adhere to their objectives as subjects of international law. International financial institutions, including the World Bank (with its five institutions), the IMF and regional development banks, have been concerned about poverty reduction and development for more than 50 years. The common goal of international financial institutions is to reduce poverty and improve peoples' living conditions and standards; to support sustainable economic, social and institutional development; and to promote regional cooperation and integration.<sup>3</sup>

Institutions such as the World Bank have important mandates, such as fighting poverty through development assistance to middle and low-income-generating countries, giving loans and training. The World Bank provides low-interest loans, interest-free credits and grants to developing countries.

These objectives and the services of the World Bank can only create the desired effect of poverty reduction if they are implemented effectively. Hence, their manner of implementation should not be overlooked. In addition to this, developing countries have to create the requisite legal infrastructure for their citizens to benefit from opportunities provided by international financial institutions and to improve awareness of such.

## **Conclusion**

From policy-making to coming up with specific rules of law that have a direct or indirect impact on access to finance, the legislature should take into account the long-term and short-term effects of such legislation on access to finance specifically and on development generally. In addition, the legislature needs to be progressive and innovative to continually improve access to finance. Improved legislation cannot bring about complete change on its own; laws also need to be effectively executed. As such, the executive also has an active role to play in this process. Both international law and national legislation have a major role to play in enhancing access to finance, directly through legislation and indirectly through national and international financial institutions. International financial institutions should effectively implement their mandates to achieve their goals in poverty reduction.



## Notes

- 1 See, 'Finance for All? Policies and Pitfalls in Expanding Access', Chapter 1, *Access to Finance and Development: Theory and Measurement*, World Bank 2008, available at: [http://siteresources.worldbank.org/INTFINFORALL/Resources/40995831194373512632/FFA\\_ch01.pdf](http://siteresources.worldbank.org/INTFINFORALL/Resources/40995831194373512632/FFA_ch01.pdf) (last accessed 30 April 2013).
- 2 See, 'Access to Finance', *Wikipedia*, available at [http://en.wikipedia.org/wiki/Access\\_to\\_finance](http://en.wikipedia.org/wiki/Access_to_finance) (last accessed 30 April 2013).
- 3 See, Naina Gupta, *Role of International Financial Institutions on Indian Economy*, power-point presentation, available at [www.slideshare.net/nainagupta/ppt-on-role-of-international-financial-institutions](http://www.slideshare.net/nainagupta/ppt-on-role-of-international-financial-institutions) (last accessed 30 April 2013).

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# How can law enhance access to finance in developing countries to reduce poverty?

As a citizen of one of the least-developed countries, poverty has always been a big part of my life. The number of things I want but can't afford to do outnumber the things I can.

Money is key to reducing poverty, although I would argue that money is not the only limitation for the impoverished. The path out of poverty is also about changing mindsets and attitudes. In most poor countries, there is limited access to education. The population may therefore be largely uneducated and dependent, with limited opportunities for work. Neither the government nor other institutions can afford to give everyone a job; there is typically a shortage of schools, healthcare and other important facilities. Women are often not given equal access to study or to work and children may be unschooled because of traditions and cultures that limit the opportunities available. Corruption may be rife; periods of famine are a further test to the system in place.

At the root of all these problems, however, is finance: the lack of adequate monetary resources. If the world's least-developed countries had the money to build infrastructure, schools, medical facilities and the like, their problems would be fewer. There is an imbalance in the availability of resources. To paraphrase Mahatma Gandhi: 'the world's resources are more than enough for the people in it, but insufficient for the greedy ones'.<sup>1</sup> It is well known that there is a

great economic gap between first and third world countries. That there is enough in the world but disparity of resources is particularly true in Africa. The continent of Africa remains the poorest and least-developed region of the world, notwithstanding its abundant resources – human and natural – and large potential markets.

All countries have the means to generate income from both internal and external sources. Thus, we can look at how law can upgrade access to finance in these two scenarios. Looking first to internal sources, it may be said that, for a country to engender economic development, there must be cooperation of sorts between its government and its people. After all, in democratic countries, it is the voices of the people that brought the government to power and have entrusted it with making decisions for the country. There must, therefore, be a sense of working together for which communication is crucial. A fundamental communication between the government and its people is the law. The government enacts laws regulating how its citizens may act, what they can and cannot do. Laws provide for the rights and obligations of people. In the same manner, what the government wishes can be found in its legislation. Thus, we can only imagine how much the quality of laws can affect the economic, social and political status of a given country. It can either break or build a nation.

For income to be generated from

internal sources, countries must create a domestic environment conducive to growth through the adoption and implementation of economic policy reforms. Countries need laws that can bring about the desired development goal.

Behind this, to function properly and to provide such services, governments, like people, need money. The most important source of governmental income in most countries is from taxation. A country's citizens contribute prescribed amounts to the government as taxes from business, personal and other sources of income. To form a robust foundation, tax laws must be sound. They should apply fairly to all members of society. They must be achievable and considerate. If taxes are too high, incentives are created to avoid paying them. The government will not be able to collect the taxes, or thereby pay for the services and infrastructure intended. Expanding the diversity of taxes (rather than simply raising tax rates) may be able to increase the tax base in ways that citizens can pay. A country with various resources must enact laws that entail their prudent and efficient management so as to add to the progress of growth.

When a person or institution imports goods, tax is paid on those imported goods. If laws impose a sufficiently low tax, imports will be encouraged and foreign currency exchange reserves increased.

Income – for the government as well as for individuals – can also be derived from investment. Laws touching on investment can encourage external investment in that country, including through low tax rates or full tax exemptions. If the legal environment and costs are sufficiently attractive, both foreign investors and diaspora communities will be interested in investing in a country, which in turn stands to increase the inflow of cash into the country. The investment laws of a country serve both internal and external investors; that is, both categories of income sources for the sake of this essay.

Tourism is another example of an industry that may be benefited by law. There are many extraordinary tourist sites in these countries but not much is done in this regard. Rules and regulations must be drawn up to facilitate the improvement of such places to be suitable for people coming from abroad to visit these sites. So law plays a great role in enhancing the way in for finance.

Secondly, we look to income from external sources. Countries that have access to coastal

waters and have ports and airlines can derive income by leasing those ports and airlines. Improving trade relationships generally through treaties, conventions and regional and international economic cooperation or trade organisations brings economic benefit and development. As a corresponding obligation, the state must generally also submit to customary or conventional international laws and treaties, either through express ratification and formally adopting them as part of its national law, or through adopting these practices.

In the same manner with imports, the export of raw materials – such as agricultural or finished products – must be supported by law. Tax is collected on exported goods to strengthen the government's financial base, which may be devoted to poverty reduction and other development programmes. Such taxes may be used to prevent or reduce the corresponding importation of goods, serving as a trade barrier. When a state wishes to ban or reduce imports into its territory, it will often impose a high tariff – sometimes as high as 100 per cent of the value of the import. The imposition of high tariffs is an effective means of discouraging imports and is the subject of much discussion in international trade law. Such protective measures can help protect infant domestic industries from competing – sometimes subsidised – products from foreign companies and importers. Domestic law may be harmonised with international laws and treaties looking to regulate trade in these areas.

Promisingly, recent studies have pointed to economic growth in Africa, although this has not yet translated into any meaningful reduction in poverty levels. Law has an important role to play in making sure the poor also benefit from economic growth. It can guarantee the rights of those who are weak, either physically or socially. Empowering women and other marginalised sectors of society can be effective in reducing poverty. Women in many of the least-developed countries suffer discrimination and are ascribed close to zero value in contributing anything to the country's development. Recently, however, some women have managed to break with tradition and prove naysayers wrong. This is just the beginning; a lot is expected in the future. For this to be fully realised, the role of law is vital. Of course, some may say that awareness-creation and a change in attitudes towards women must be done first.

A country's laws must promote women's participation in the process of development. Women, and all marginalised sectors of society, must be granted equal opportunity to seek an education and jobs that increase their capacity for productive employment and fair income, so as to be independent and competitive in the marketplace. Coming from one of the world's least-developed countries, I personally doubt we can afford to exclude even one person, let alone millions, in our mutual fight against poverty. Consequently, when legislation is passed, I believe it should take into consideration the position of women and include affirmative action clauses to put women on an equal footing with men.

Similarly, laws must also be protective of people with disabilities. Be the impairment that of hearing, a physical ailment, a visual limitation or otherwise, such people can nonetheless contribute to the economic and social advancement of a nation. Therefore, since poverty is heavily concentrated among disadvantaged groups, law must be proactive in addressing the needs and encouraging the potential of these groups. Their participation in political endeavours and leadership activities must also be encouraged.

The above touches on a few sources of government income and, similarly, what a country's laws may look like. So far, I have discussed the role of law in improving access to finance. As mentioned at the start of my essay, law is an instrument; it's a means to an end rather than an end in and of itself. However great the rules and regulations of a country may be, they don't necessarily grant the goals of the legislation to be achieved. As important as substantive laws that provide for the financial improvement of a state are, procedural laws are also important. Provisions of the law are just words, unless put into practical effect. Thus, in addition to strong laws, we need effective mechanisms to implement those laws.

There are also other problems. Assuming certain laws were correctly implemented and able to bring about the desired goal, which is to grant better access to finance, a follow-on question is to ask where the money should go. We see instances where, in some countries, there is a lot of foreign aid through loans or donations. Yet, in spite of sizeable contributions of foreign aid, poverty persists. No one dares ask where

it went. Accountability and transparency seem to be lacking, fostering corruption. A Nigerian lawyer and politician, Chief Obafemi Awolowo, once said: 'It will, I believe, be generally agreed that eradication of corruption from any society is not just a difficult task: it is without dispute, an impossible objective.'<sup>2</sup> It may seem to be easier said than done, but I believe it's possible if done one step at a time. It is just as with any evil in our society; and it all comes down to knocking out substantive laws and their implementation. Anti-corruption laws must be tight and non-discriminatory between government officials and people. They must also provide for strict penalties so that they serve the purpose of deterrence. But again, as I have said earlier, laws don't suffice. Enforcement mechanisms and the institution responsible for such tasks must also be available. If rightly applied, I don't see why we can't tackle the problem.

Lastly, an important factor in improving growth or reducing poverty is effective governance. All that has been said will amount to nothing if there is no political stability in a country. Adherence to the principles of democracy, equality and the rule of law are undeniably essential. No organ of a government can function well in an unfavourable environment. No legislation will be implemented or even executed for that matter. And, in return, this diminishes the chances of robust and sustainable development.

#### Notes

- 1 'Earth provides enough to satisfy every man's needs, but not every man's greed', Mahatma Gandhi, available at [www.goodreads.com/quotes/tag/environment](http://www.goodreads.com/quotes/tag/environment) (accessed 3 April 2013).
- 2 See *Journalism vs 'Brown Envelopes'*, The Media Project, Thursday 4 August 2011, available at: <http://themediaproject.org/article/nigerian-journalism-culture-brown-envelopes?page=0,3> (accessed 7 April 2013).

Ms Redeat Kassahun Seifu is a law student at Addis Ababa University, Addis Ababa, Ethiopia. Her article was one of the highest-ranked essays in the Lex:lead Group's 2012 annual scholarship competition as decided by a panel of international judges, lawyers and academics, judged independently. Redeat Kassahun Seifu's award was funded by a grant to the Lex:lead Group from the Claude Moore Charitable Foundation. For more information, please visit [www.lex-lead.org](http://www.lex-lead.org).

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**A**ccess to finance as a concept should be distinguished from the use of financial services, because the non-use of finance can be either voluntary or involuntary.<sup>1</sup> Usually, the focus of access to finance as an area of research is on those who involuntarily only have limited or no access to financial services. These groups are referred to as the ‘under-banked’ and ‘unbanked’, respectively. Such individuals may be ineligible for or unable to take out loans from formal credit-providing financial institutions. Their only access to finance may be at usurious rates through the informal (and unregulated) sector; or they may have no access at all.

Communities with very limited financial resources may be provided an opportunity to gain access to lines of credit to start projects or develop existing ones. In countries like Ethiopia that have severe financial constraints, microfinance institutions play a significant role. They provide small amounts of financial help and track the use of the credit provided. They also encourage savings. As part of their services, these institutions improve financial literacy by giving guidance on financial decision-making. In developing countries, financial decisions made by individuals usually affect a wide circle of people. So, with the current financial and institutional complexities comes the responsibility of making a well-founded decision. The basic goal of access to finance can be facilitated by improved financial literacy; access can be improved. Improved access provides the means to encourage innovation and the entrepreneurial skills of the poor.

Financial limitation is the greatest challenge faced by potential entrepreneurs (especially locals) in either starting up a project or expanding an already-existing enterprise. The lack of money undercuts job opportunities and the country’s potential productivity, especially when a local investor wants to engage in an investment similar to the one formerly established by foreign investors – the above limitation can be of great influence. Foreign investment in a

developing country is introduced on the rationale that the investor would import capital to the host state and introduce new skills. So competing with foreign investors would be impractical for local up-and-coming investors and entrepreneurs.

One basic rationale behind having a legal system and designing laws is to maintain fairness and equality among the individuals governed by them. Laws are designed for the good of the communal interest. So providing a regulatory framework would benefit all and remove imbalances created from different levels of social and economic status. Laws also fill the gap of uncertainty in financial transactions.

States usually have three layers of legislative responsibility when it comes to taking active measures – international, regional and national. The International Covenant on Economic, Social and Cultural Rights (ICCPR) at Article 2 talks about how individual states should take measures of an economic and technical nature with a view to progressively achieving the full realisation of the right to development. Legislative measures are particularly listed. Another relevant article is ICCPR Article 4, which talks about enjoyment of the right and legal limitations. This can be applied when financial institutions nominate beneficiaries; it should be according to the legal requirements provided by the law of the land. The provisions for this legislation should also be made with the purpose of promoting the general welfare of the society. Regional and national obligations usually reinforce what is set out under the international conventions.

From a human rights’ perspective, effective access to finance contributes to better education, food and employment standards. Improving financial rights requires a more robust and responsive legal system. This right should be respected, protected, promoted and facilitated by states parties that assumed treaty obligations. Vulnerable groups, particularly children, women and ethnic minorities, should have sufficient access to finance and production-related resources.



### An imbalance in the making: the 'who' question

'In the medium to long run, if microfinance is to be fully integrated within the formal financial sector, and if the needs of poor households and enterprises are to be met completely and sustainably, supportive legal and regulatory frameworks are ultimately necessary.'<sup>2</sup> This necessity goes with internationally accepted principles and obligations assumed by states. States have sworn to work towards eradicating poverty and to feed 9.5 billion people by the year 2050. Now, the real question is: are we planning on feeding those already rich, or is this a promise to the underfed?

This question can only be answered in the priorities designed by the policy of different states and further pursued in legislative frameworks.

When we talk about access to finance or microfinance institutions, one name that comes to mind is Muhammad Yunus, for having created a feasible plan to support the poor. Although people like Muhammad Yunus choose to cater for the poor, governments usually cater for the needs of the rich under a pretext of feeding the poor. The national laws of developing states on banking and insurance exhibit this same nature. This has been challenged by different advocacy institutions. Because of the high opposition from the majority, the governments of developing countries are in a dilemma over designing a social protection scheme to address the needs of the poor. These social protection measures would give citizens direct or indirect access to finance as a legal right. The concerns of government authorities usually demand the contribution of deeper pockets. The rich are considered a means of capital and income so that whatever they demand is fulfilled. This demand includes access to finance from formal financial institutions. Due to this, the institutions set regulatory measures that are distant from the reaches of the poor. Here, designing a more feasible law could play a very significant role in shaping the expectation and priorities of states.

As laws are instruments of social change and progress, if designed carefully, they can adequately address the 'who' question. Laws could also deal with the apportionment of finances on a more transparent and efficient

basis. At a national level, laws are crafted by representatives of the people so their agendas are presumed to address the concerns of the same.

### Deeper pockets should be regulated

Financial services are usually provided by commercial banks, credit unions and national or international non-governmental organisations (NGOs). These are institutions that are recognised by the state and laws. On the other hand, individuals unable to measure up to those standards or regulations entailing access to finance resort to an illicit way of acquiring it. When we talk about the illicit nature of the practice, it mainly focuses on an interest rate. We have regulations in banking, and national banks of states usually dedicate a particular department to ensure its enforcement in practice.

Rich individuals take advantage of the informal lending mechanism through the imposition of high-interest rates. This practice is usually scrutinised by particular agencies established under the national finance structure. Such agencies are guided by a set of laws having procedural remedies. Such laws are crafted based on policy considerations for the benefit of the majority. The rationale behind having these laws is social interest protection and governance of access to finance. Finally, grass-roots NGOs could play a significant role in catering for the needs of the community by paying closer attention to specific social constraints.

### Conclusion

In order to have a more feasible and efficient financial set-up, we need to design a comprehensive legal framework. Laws regulate social behaviour and operational standards with mechanisms of enforcement. When we talk about finance and poverty reduction, an overriding interest of the state is involved. Hence, the state should protect it at any cost. States should be able to regulate illicit financial practices and take the financially weak into consideration. Policy objectives should be drawn up on an inclusive basis and discrimination on access should be eliminated. Finally, financial laws should be able to facilitate the reduction of poverty and provide poor entrepreneurs with the chance to grow.

#### Notes

- 1 A Demirgüç-Kunt, T Beck and P Honohan (2008) *Finance for All?: Policies and Pitfalls in Expanding Access*,



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# How can law enhance access to finance in developing countries to reduce poverty?

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**F**inance is defined as managing money especially by a government or commercial organisation, or to provide money for a project.<sup>1</sup> It may also involve how investors allocate assets over time under conditions of certainty and uncertainty. The practice of finance aims to price assets based on their risk levels and expected rates of return. There are three broad categories: public finance, corporate finance and personal finance.<sup>2</sup>

Conversely, 'developing country' is a term used in international development. Different criteria group countries as developed, developing or least-developed. The World Bank looks to per capital income as a basis of classification, while the United Nations uses a human development index to rate the development levels of countries.<sup>3</sup> It is generally agreed that developing countries are poor; but measuring *how* poor introduces complications.

Taking into account the fact that poverty is an inequality in the allocation of material goods, where income inequality is an indicator of poverty, the level of poverty is calculated according to the extent to which basic needs are met. Developing countries generally have poorly developed social services, and it is common to find high levels of aid in such countries that are unlikely to be accessed easily otherwise.

The literature provides both theoretical arguments and empirical evidence that a country's legal system fundamentally affects its ability to attract and use finance, as well as its overall economic growth. The directional impact goes from finance to growth; an

important channel for the impact of finance on growth is the informational asymmetries and transaction costs.<sup>4</sup>

Prevailing practices in law align with dominant political interests,<sup>5</sup> and the choice of law has an impact on financial development. A failure to account for the political economy and its effect on the legal environment can lead to a misreading of the relationship between law, finance and growth,<sup>6</sup> leaving some sectors without an effective means of participating. As such, law can have a great impact on reducing poverty, by improving access to finance in different ways, directly or indirectly. The legal environment affects the ability of firms and other developmental organisations and institutions to raise internal and external financing and thus to overcome financial constraints.

## The free movement of services and capital through trade and trade laws

Trade growth requires that trade be open as the only real option, especially for developing countries with small economies such that they may surmount the obstacles of the small size of their domestic market. International trade therefore is well-regulated by international conventions and agreements, including the Hague Rules of 1924 and 1968, the Hamburg Rules of 1978, the Warsaw Convention of 1929, the Hague Protocol of 1955 and the Montreal Protocol of 1975. These instruments regulate states so that they do not affect trade through state actions, like economic consideration and

protectionism. Cross-border trade helps in the distribution of resources that don't exist in other states, expand access to markets and employ means of financing, such as letters of credit. Through the free movement of people and services, greater income can be generated for the subjects of the trade, which further increases the per capita income of the individuals.

### International relations and laws of development

Countries form either bilateral or multilateral organisations or corporations intending to solve their problems. Among the problems they tackle are economic problems. Examples of the organisations or corporations formed are the Economic Community of West African States (ECOWAS), the East African Community (EAC), the African Union (AU) and the United Nations (UN). Most of these were formed through signing treaties that pass resolutions and conventions that bind the member states either automatically or through ratification. For example, in 2003, the AU passed a resolution in Maputo.<sup>7</sup> On reiteration, it committed to the principles and objectives set out in the Constitutive Act of the AU and the common conviction that sound economic policies are essential conditions for the sustainable socio-economic development of the African continent. It further re-emphasised the common resolve to eradicate poverty, confront underdevelopment and arrest the marginalisation of the African continent. It further showed its mission by encouraging the New Partnership for Africa's Development (NEPAD) Heads of State and Government Implementation Committee to explore adequate funding mechanisms for sustainable financing of NEPAD programmes and projects, including the possibility of a NEPAD Trust Fund. It revealed its true preposition that law need not be neglected once it comes to development of a country.

### Law, economic innovation and investment in economic growth

Law and innovation are inseparable. For democratic countries, the rule of law is one among the constitutional principles.

'It is widely understood that the "rule of law" is essential for economies to grow, and thus for living standards of their populations to advance. In turn, it also

is widely recognised that growth is best achieved through continued innovation: the development of new products, new services, and new ways of doing things that make a society more productive.'<sup>8</sup>

Individuals will not save and firms will not invest without clear property rights, enforced if necessary by an impartial judicial system, in the interest of profits they earn on these investments.

Companies cannot attract outside investors and thus may not be able to grow unless the liability of shareholders is limited to the size of their stockholdings.

Similarly, individuals and institutions are more likely to invest in financial instruments that can be easily and readily traded. Exchange must exist to facilitate such trading, as must investor-relevant rules requiring disclosure of accurate and timely information.

These are just a few of the legal propositions that are now widely understood to foster economic progress. Laws and legal institutions best promote innovation and growth.<sup>9</sup>

This takes us to the crucial fact of introduction of M-Pesa in East African countries. M-Pesa is a mobile phone-based money transfer (Pesa is a Swahili word meaning money) and micro-financing technology in partnership with Vodafone Group (Safaricom for Kenya and Vodacom Tanzania). It is an innovative money-transfer solution that enables customers to send money directly, even internationally, to the receiver of an M-Pesa account. This was launched in Tanzania in 2000<sup>10</sup> and was introduced in Kenya in 2007.<sup>11</sup> M-Pesa has shown that leveraging mobile technology is a promising vehicle for extending financial services. In Kenya, the money transferred each year equates to 11 per cent of the gross domestic product (GDP).<sup>12</sup> The legal framework (policies) has been flexible to allow rapid introduction of mobile transfers throughout the country, while at the same time regulations and control processes needed to provide security have kept risk largely contained.

### Tax law and public financing

Taxation is a central part of modern public finance. Its significance arises not only from the fact that it is by far the most important of all revenue, but also because of the gravity of the problems created by the present day tax burden. The main objective of taxation

is to raise revenue. A high level of taxation is necessary in a welfare state to fulfil its obligations. Taxation is used as an instrument of attaining social objectives, that is, as a means of redistribution of wealth and thereby reducing inequalities. Taxation is also used to draw away money that would otherwise go into consumption and cause inflation to rise.

In general, the legal framework calls for taxation according to the rule of law. The fundamentals of this framework are that tax can be levied only if a statute lawfully enacted so provides.<sup>13</sup> Taxation is a handmaid for raising revenue to meet governmental expenditure. Imperatively, the government has to provide social services and ensure defence and hoarding of other undertakings, which the free market or the state feels is better provided by itself.<sup>14</sup>

### Conclusion

As noted thereof, the Romans might never have arrived at developing the early type of corporation without their advancement of the legal environment. Disregard for law or to making laws match the times and circumstances is as good as having a car with no key. Law moves the economy of a country and also directs its future. In no way can a country's economy take steps forward without law. It is essential to keep eye on the legal framework of a country so that it protects the sustainable use of natural resources, and has clear constraints against free flow and supply of services and transfer of technology. Otherwise, the term 'developing countries' (that is sometime faked) applied to countries with poor social services and low per capital income will stand until Doomsday.

### Notes

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- 3 See, [www.fundsforngos.org](http://www.fundsforngos.org).
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- 5 *Ibid.*
- 6 *Ibid.*
- 7 Maputo Declaration, Second Ordinary sessions, 10–12 July 2003/Assembly/AU/Decl 8(II). Declaration on the Implementation of the New Partnership for Africa's Development (NEPAD).
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- 10 See, [www.vodacom.co.tz](http://www.vodacom.co.tz).
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- 14 *Ibid.*

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