BRİDGİNG THE GAP? MİCROFİNANCE INSTİTUTİONS AND INEQUALİTY İN DEVELOPİNG ECONOMİES

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Abstract: We analyze microfinance institutions and inequality relationship in developing economies and use data from 2000 to 2018 on 60 developing countries. The findings reveal a dual impact of microfinance institutions: their social performance—manifested through financial inclusion and empowerment—contributes to reducing extreme inequalities, particularly by uplifting low-income populations. In contrast, certain aspects of financial performance, such as operational self-sufficiency (OSS), may inadvertently reinforce income concentration at the upper end of the distribution. This suggest that, on the one hand, social inclusion efforts may also benefit the wealthiest segments of society, possibly through indirect effects on overall economic activity. On the other hand, the growth of this share is strongly and negatively correlated with the risk portfolio, indicating that the financial vulnerability of MFIs tends to reduce income concentration at the top, perhaps by curbing the allocation of credit to the most profitable segments.

Keywords: *inequality, microfinance, causality.*

INTRODUCTION

The persistence of income and wealth inequality in developing countries has garnered increasing attention in global economic and policy discourse. In this context, microfinance institutions (MFIs) have emerged as a prominent development intervention aimed at promoting financial inclusion and poverty alleviation. This paper explores the multidimensional relationship between inequality and microfinance, analyzing whether and how MFIs contribute to reducing disparities in access to capital, income distribution, and long-term social mobility.

MFIs are financial intermediaries that combine the characteristics of formal and informal financial systems and improve the quality and accessibility of financial services by helping low-income populations access credit (Kamath, 2009). Moreover, Nandelenga and Oduor (2020) examine the case of sub-Saharan Africa and highlight the asymmetric effects of financial inclusion on income inequality in both the short and long run—particularly through channels such as liquidity liabilities and private sector credit. They contend that increases in GDP per capita contribute to a reduction in income inequality, a proposition also supported by Sylwester (2002).

METHODOLOGY

We analyze data from 2000 to 2018 on 60 developing countries.

Our empirical strategy employs the panel vector autoregression (panel VAR) methodology, originally developed by Holtz-Eakin et al. (1988), which integrates the traditional VAR framework introduced by Sims (1980) with panel data techniques. A key strength of the panel VAR approach lies in its capacity to model all variables as endogenous, thereby capturing the dynamic interrelationships between the Human Development Index and the financial and social performance of microfinance institutions.

FINDINGS

Firstly, the growth in the share of income held by the richest 10% is positively influenced by the social performance of MFIs.The share of income held by the top 1% shows strong inertia (autoregression coefficient = 0.762, $p < 0.01$) and is positively correlated with social performance (positive logOSS and logPAR) but negatively correlated with financial performance (logPFB and logPAR significantly negative).

The growth in the share of income held by the poorest 50% (dp0p50) responds positively to improvements in MFIs' social indicators, particularly the increase in the number of clients served (logNOB) and operational self-sufficiency (logOSS), which highlights the favourable impact of expanding access to microcredit on low incomes.The growth in the share of income held by the poorest 50% (dp0p50) responds positively to improvements in MFIs' social indicators, particularly the increase in the number of clients served (logNOB) and operational self-sufficiency (logOSS), which highlights the favourable impact of expanding access to microcredit on low incomes.

CONCLUSIONS

Overall, the results highlight a dual effect of MFIs: their social performance (through inclusion and empowerment) tends to reduce extreme inequalities, particularly by supporting low incomes, while certain improvements in financial performance (such as OSS) can sometimes reinforce the concentration of income at the top, raising the question of a balance between economic efficiency and social equity in the mission of MFIs.

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