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## On the Ground

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### The Role of Microfinance

By **NICHOLAS KRISTOF**

*Does the aid world exaggerate the benefits of microloans? How much do they help? Here's a thoughtful, evidence-based analysis by three economics professors: Abhijit Vinayak Banerjee and Esther Duflo of M.I.T, and Dean Karlan of Yale. Their work is sometimes cited in critiques of microlending, so here's their take:*

Microcredit is undoubtedly the most visible innovation in anti-poverty policy in the last half century. In the three decades since Mohammed Yunus gave his first loan to a group of Bangladeshi women, the number of microcredit borrowers has crossed 150 millions. The majority had no access to credit from banks before microcredit came to them. When they needed to borrow, and most people do at some point or the other—to pay for an illness or a wedding, to grow a business or to fix their roof—they would go to money lenders and pay rates that have, justly or otherwise, accounted for the universal unpopularity of moneylenders (they can be over 20% per month). Now they borrow from MFIs at significantly lower (though often high by US standards) rates. At the same time MFIs have managed to find ways to be financially sustainable and to keep growing fast.

This is itself a remarkable achievement. Very little works in many of these countries in terms of delivering to the poor; previous attempts to deliver credit, through state-run banks, for example, collapsed in the face of widespread corruption and defaults. Many microcredit institutions are led by dynamic entrepreneurs who have mastered quality service delivery on a large scale, a tough challenge in many developing countries.

However, many see microcredit as much more than a financial instrument: it has been suggested that it has the potential to be entirely transformative. There is an influential view that argues that, by putting more spending power in the hands of poor families, and, perhaps more importantly, in the hands of women, microcredit can expand investment in child health and education, empower women and reduce discrimination against them. There is even the suggestion that, by making people feel that their lives could be better and giving women independent access to capital, microcredit could fight the AIDS epidemic.

There are, of course, others who are skeptical or even hostile. They see MFIs as old-fashioned money-lenders, preying on the inability of people to resist the temptation of a new loan. One self-described expert, in a recent letter to the Financial Times, goes as far as to suggest that microcredit leads to the "death of the local economy".

Unfortunately, till very recently, there was little rigorous evidence on either side—is microcredit transformative or ruinous? However this is changing now, thanks to the courage and vision of a few leading MFIs (including Spandana in India, Al Amana in Morocco, First Macro Bank in the Philippines, Compartamos in Mexico) that have allowed researchers (each of us was involved in one or more of these) to evaluate rigorously the impact of their

programs. We now have results from two (Spandana and First Macro Bank).

The two programs evaluated are very different. First Macro Bank provides loan to existing business owners, male or female, on an individual basis. Spandana uses the classic group-lending model and lends only to women.

Yet at one level the results are remarkably similar. The effect on businesses is not dramatic but some clearly benefit. In the Philippines, male-owned businesses increase profits, although female-owned businesses do not. In India, borrowers who already own a business buy assets for their business. One borrower out of eight starts a business they would not have started otherwise. Others buy durables for their homes.

However, there is no evidence that microcredit has any effect on health, education, or women's empowerment, at least right now, eighteen months after they got the loans. On the other hand, there is also no evidence that people are behaving irresponsibly. Indeed in India we have evidence of people giving up some of the little daily pleasures of life (like tea, snacks, betel leaves and tobacco), to pay for bigger things that they could not previously afford (carts for their business, televisions for their homes).

Many seem to think that this is not enough. However, as we see it, microcredit seems to have delivered exactly what a successful new financial product is supposed deliver—allowing people to make large purchases that they would not have been able to otherwise. The fact that some people expected much more from it (and perhaps they are right, may be it will just take longer), is perhaps inevitable given how eager the world is to find that one magic bullet that would finally “solve” poverty. But to actually blame microcredit for not promoting the immunization of children is no different from blaming immunization campaigns for not generating new businesses.