

# **The four crises of Microfinance: poverty reduction, excess profits not transparent and serial borrowing...**

**UARM-Lima 2012 presentation**

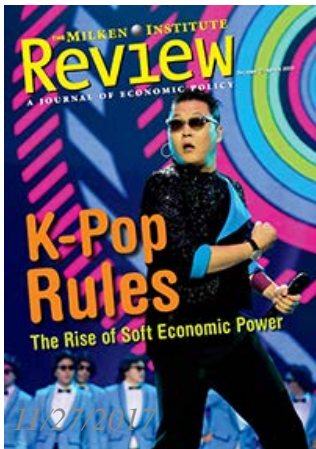
**Updated October 2017**

**Professors McLeod & Fuentes**

**Economics 5808, Summer 2015**

# Morduch, 2014 How Microfinance really works

Milken  
Review  
(cover: )



# Four Microfinance crises:

**1. Efficacy:** does microfinance reduce poverty and help the women & families it targets? Recent [RCTs question these claims](#), the last word? ( [Banerjee et al. 2015](#)'s JPAL RCT attack or see [Yale Insights](#))

**2. High interest rates: Is Mexico's [Compartamos too profitable](#)?**  
What's wrong in Andhra Pradesh, group lending or too many loans (see [Aljazeera video Asia 101](#)), Mibanco, ADOPEM, become banks... mission drift....

**3. Asian MFIs lack transparency: as do KIVA/Whole Planet** peer to peer lending, default rates not as advertised; Ananya Roy's public vs. private transcript. Morduch's thesis Asian **microlending subsidized by large NGOs BRAC, ASA, NIDAN, Grameen all examples.**

**4. LatAm ethical dilemma/profitability should one** profit from lending the poor. MFIs are “too profitable” Accion executive salaries,

**Efficacy do MFIs reduce poverty?** Do MFIs help the poor? Empower women? J-PAL & others questions impacts, see [CGD's "final word"](#) and FAI's "[hopefully not](#)"

- Special issue AEJ Applied economics includes "Six Randomized Evaluations of Microcredit" show few consistent and no "transformative" impacts of microfinance in six countries including Mexico... see [Banerjee et al. \(2015\)](#) (see below for reference)
- J-PAL long skeptical, low interest rates or high, financial markets in general suspect....

# **Crisis #1 Efficacy:** Does Microfinance reduce poverty and empower women? J-PAL & others questions impacts, see [CGD's "final word"](#) and FAI's "[hopefully not](#)"

- Randomized trials the last word? see deworming [replication](#) controversy [Replication](#) took many years Nobel prize winner says it does not work, see Angus [Deaton "Randomistas"](#), 2009 External validation?
- What about micro-saving and financial access with transfer programs "the Bangladesh consensus" [SafeSave](#) ; [P9](#) ;
- Replace with 6-step "graduation" program?
- Justin Sandefur, "[The Final Word on Microcredit?](#)" Center for global development, blog 1/22/15



# Sandefur, 2015 Final Word on Microcredit?

## The impact of microcredit: 6 RCTs

	Bosnia	Ethiopia	India	Mexico	Mongolia	Morocco
	Men & women, individual loans, \$1,800, 22% APR	Men & women, group liability, \$500, 12% APR	Women only, group liability, \$600, 24% APR	Women only, group liability, \$450, 110% APR	Women only, individual & group, \$700, 27% APR	Men & women, group liability, \$1,100, 15% APR
↑ = (+) significant ✕ = insignificant ↓ = (-) significant						
Credit access	↑	↑	↑	↑	↑	↑
Business Activity	↑	↑	↑	↑	✕	↑
Income	✕	✕	✕	✕	✕	✕
Consumption	↓	↓	✕	✕	↑	✕
Social effects	✕	✕	✕	↑	✕	✕

# Grameen bank & Muhammad Yunus won the 2006 Nobel peace prize... but it has been a rough decade

- The 2006 Nobel Peace Prize is given jointly to Muhammad Yunus and Grameen Bank ***"for their efforts to create economic and social development from below..."*** (click graphics to see prize profiles)
- Almost from day prize awarded, Microfinance & Grameen have run into difficulties...
- Yunus forced to leave Grameen Bank after a Norwegian (Danish?) documentary accused him of mishandling \$100 million (NY Times 2011 [Microlenders honored, now struggling](#))



Subsidized lending via Aid or NGOs Bangladesh private vs. public transcript, subsidized lending via NGOs at lower rates than cost..

*\*Nobel Peace Prize 2006". Nobelprize.org. 14 Jun 2012*  
[http://www.nobelprize.org/nobel\\_prizes/peace/laureates/2006](http://www.nobelprize.org/nobel_prizes/peace/laureates/2006)

11/27/2017

*Four Crises of Microfinance*

# What is Microfinance? Mainly from excellent review by [Karlan and Goldberg \(2011\) chapter 1](#) of the Handbook

- (1) Small transactions and minimum balances (whether loans, savings, or insurance).
- (2) Loans for entrepreneurial activity.
- (3) Collateral-free loans.
- (4) Group lending (not Grameen II post 1998)
- (5) Focus on poor clients in rural areas.
- (6) Focus on female clients.
- (7) Simple application processes.
- (8) Provision of services in underserved communities.
- (9) Market-level interest rates?

**Microfinance is some mix of the above....**



# Microfinance Models and Controversies

*Three models combine or add to the above:*

- 1. Group lending, Grameen I, targets poorest women, group lending, self help groups (led to bad outcomes in India)*
- 2. Individual lending, small loans perhaps at high rates*  
Compartamos in Mexico and and SKS (Bangladesh public transcript, especially Grameen II).
- 3. Subsidized lending via Aid or NGOs Bangladesh private transcript, Kiva, subsidized lending via NGOs at lower rates than cost.. Microlending and savings is subsidized by donors, aid agencies or governments, BRAC, ASA, NIDAN, Grameen all examples. Interesting hybrids combine micro-saving and financial access with transfer programs: [SafeSave](#) ; [P9](#) ;*

# Microfinance Controversies old and new

1. *High interest rates, growing pains (aggressive collection violence?) fuels IPOs but Yunus calls Compartomos et. al. moneylenders... he wants cap of 25% or 10-15% spread*
2. *recent experiments show limited poverty reducing potential of Microfinance; ethnographies reveal poorest hurt by loans they cannot repay....*
3. **Transparency:** profit and customers hidden from view of donors, Kiva and Whole Planet do not match lenders to borrowers as suggested by pictures, and agents may be charging high interest rates (no APR posted or checked).

# Yunus: cap interest rate 25% + cap

## Op-Ed Contributor

- **Sacrificing Microcredit for Megaprofits**
- **By MUHAMMAD YUNUS**
- **Published: January 14, 2011**
- Dhaka, Bangladesh
- IN the 1970s, when I began working here on what would eventually be called “microcredit,” one of my goals was to eliminate the presence of loan sharks who grow rich by preying on the poor. In 1983, I founded Grameen Bank to provide small loans that people, especially poor women, could use to bring themselves out of poverty. At that time, I never imagined that one

Residents of Madoor village in Andhra Pradesh, India. Leaders in the state have accused microloan lenders of impoverishing  
[http://www.nytimes.com/2011/01/15/opinion/15yunus.html?\\_r=1](http://www.nytimes.com/2011/01/15/opinion/15yunus.html?_r=1)

# Terrible news from Andhra Pradesh, India



Residents of Madoor village in Andhra Pradesh, India. Leaders in the state have accused microloan lenders of impoverishing customers.

By [VIKAS BAJAJ](#) Published: January 5, 2011

11/27/2017

*Four Crises of Microfinance*



# Wonderful news from Kenya on Financial Access

## See Tavnee Suri and William Jack (2016) Science

# MIT News

ON CAMPUS AND AROUND THE WORLD

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FULL SCREEN

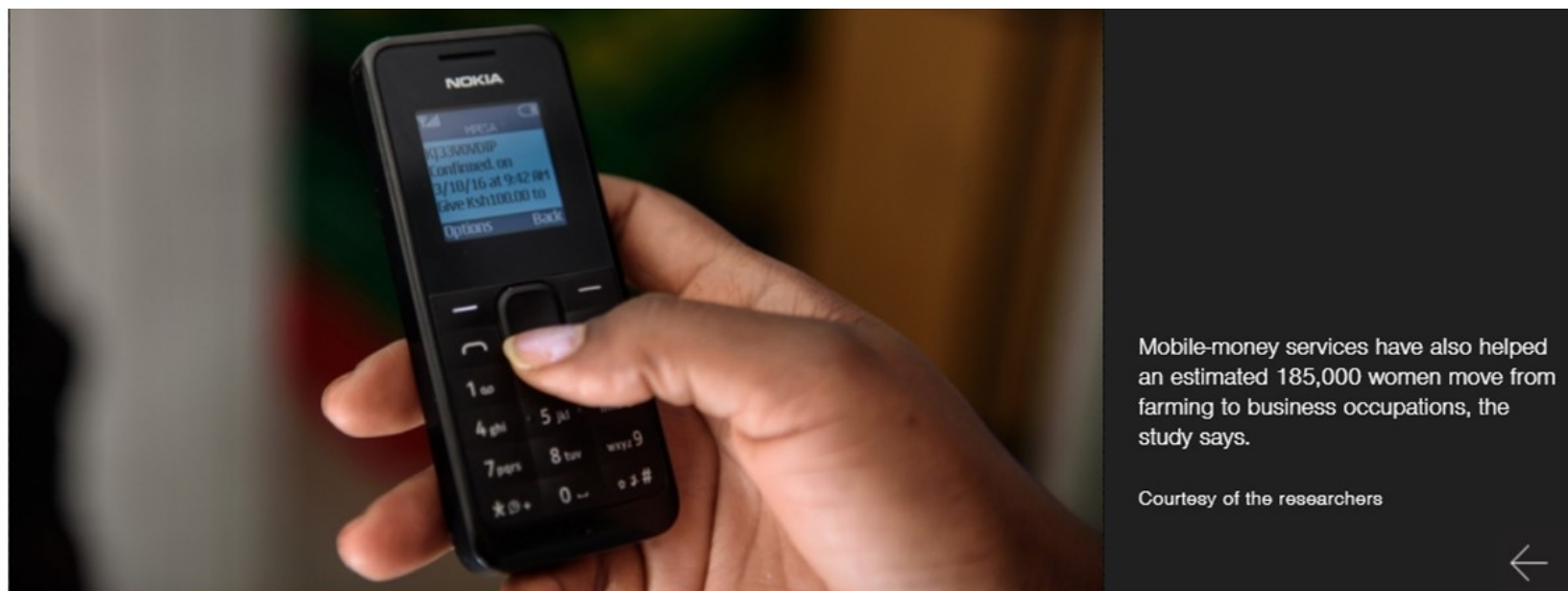


A new study estimates that, since 2008, access to mobile-money services — which allow users to store and exchange monetary values via mobile phone — increased daily per capita consumption levels of 194,000, or roughly 2 percent, of Kenyan households, lifting them out of extreme poverty (living on less than \$1.25 per day).

Courtesy of the researchers

# Wonderful news from Kenya on Financial Access

See [Tavnee Suri and William Jack \(2016\) Science](#)



## Study: Mobile-money services lift Kenyans out of poverty

Greater access to services raises daily spending, especially among female-headed households.

Rob Matheson | MIT News Office

December 8, 2016

Four Crises of Microfinance

▼ Press Inquiries

PRESS MENTIONS

# Microfinance pros and cons

## Critics say:

- Recent evidence casts doubt on poverty reduction
- High rates create big profits for lenders poor pay high rates
- Can harm poorest families: some lose land and belongings.
- Not a job...risky compared to wage employment
- low productivity, limited market
- CCTs may be better in short run & long run (education & health)

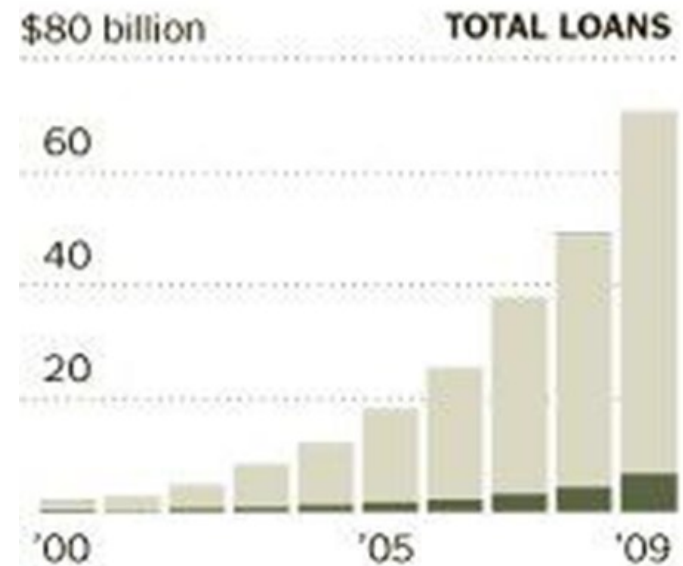
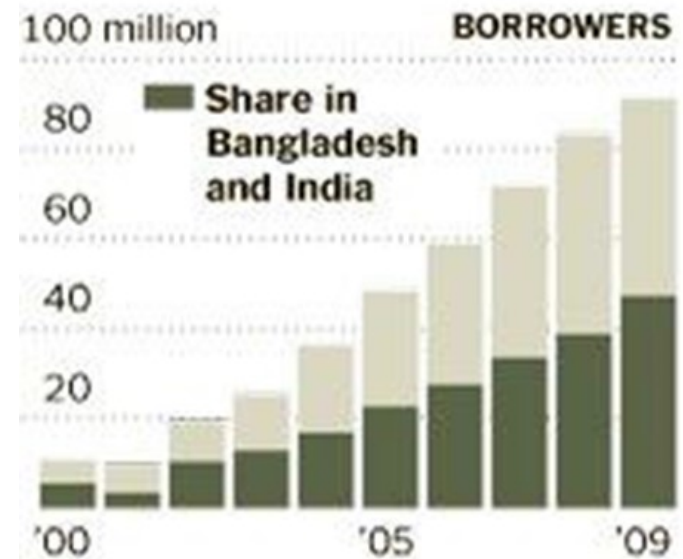
## Defenders of MFIs

- Jury is still out, RTS not “gold standard” what is? Deaton,
- Right incentives compared to aid (bottom up).
- Rates reflect higher transaction costs for small loans.
- Nominal Interest rate caps close door to private capital
- Empower womens, encourages entrepreneurship
- Better incentives than some forms of AI

# Vikas chronicles crisis “overlending” crisis EPS India

## Lending to the World's Poor

Government officials in India and Bangladesh have said microcredit lenders exploit the poor. The two countries account for more than half of the world's microcredit borrowers, although they account for a far smaller share of the total money lent.



Source: Microfinance  
Information Exchange



# Ananya Roy's Bangladesh Consensus\*

*The critics of Microfinance are correct, but do not understand that...*

1. **Access to credit is a human right** (with or w/o cap?) Safe savings vs. risky borrowing interest rates are irrelevant, whatever it takes...
2. Microfinance key component of a **broader social safety net**... examples ASA, BRAC and Grameen (also Nidan in India) + development strategy.
3. **Public transcript “sales pitch”**: Microfinance is self-financing and profitable, but this is basically wrong— **private transcript owns subsidy component and embeds MFIs in strong safety net** (Progressa, Bolsa Familia, most LAC CCTs transfer electronically)
4. MFI subsidy component runs at about 30%: about 70% costs self financed (Morduch's PhD thesis) see [Nidan video](#)...7.5 mins
5. Grameen II shares some common ground with Accion moves from group to individual lending... + savings. Grameen becomes a bank

*\*See Ananya Roy, 2010, Poverty Capital [pp. 93-132](#).*

# Mohammed Yunus' Bangladesh miracle

1. *Empower women* education & health programs  
(NGOs +UNICEF+WB –NARI)
2. *Microfinance* + NGO shadow government  
(Grameen, BRAC, ASA)
3. Garment exports; *women's jobs* college  
educated entrepreneurs...?? (UNDP unleashing  
entrepreneurship report)
4. NGOs/*social entrepreneurship*: mobile Phones  
Grameen phone, Grameen Yogurt
5. MIA: Migration and remittances?? Check this.

*\*See also Poverty Capital [pp. 93-132](#) first 10 minutes of this video.*

# High interest rates for and against

## For high market rates:

- Costs for small loans are higher than large loans as % of loan
- Local moneylenders charge and hurt more (Sopranos pilot)
- Demand for return to loans is high, among self employed
- Private capital becomes source of finance for the poor.
- High rates select neediest borrowers, assure supply of funds when needed.
- Subsidized lending breeds corruption misallocates capital
- Poor have no collateral (see Hernando de Soto & R&Z)
- Hard to enforce interest rate caps (savings set aside).


## Against high rates

- High rates can make poorest poorer... the poor always pay
- Moral outrage, predatory lending
- Adverse selection: attracts risky borrowers.
- Moral Hazard & Time consistency problems worse
- Nominal caps close door to private capital restrict supply
- Better incentives than other forms of aid
- Why not subsidize lending to the poor (Morduch?).
- Poor lack legal protection from money lenders (suicide)
- Asymmetric information problems can be addressed

# How best to reduce cost of borrowing?

1. Obvious is caps: lead to other problems: ration credit of credit, relabeled fees, overdraft charges
2. Cap on spread better, but hard to explain or enforce .
3. Reduce asymmetric information: credit reports, APR groups... stops overborrowing multiple loan problems
4. Increase competition in loan market (multiple loans?)
5. Give poor collateral (De Soto's idea, tyranny of collateral—see also Rajan and Zingales, )
6. Make collection easier (French vs. Spanish legal system)
7. Subsidize lending or guarantee loans (Fannie Mae) but then how to target? Tie to other forms of assistance?
5. Financial Literacy, encourage savings, legal aid, consumer bill of rights, labeling transparency (APR)





Or introduce  
new  
technologies:  
raise return to  
businesses or  
reduce cost

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MPESA works... encourages business startups raising incomes and reducing poverty... see Science, 2015.

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• Export markets, new technologies (sewing machines, tractors, tube wells; Nopales example...)

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• Mobile money, branchless banking, ends less dangerous than [cash](#)... remittances less costly more frequent via mobile phones– [economics of M-PESA](#)

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**New products:** mobile phones, (Grameen yogurt) water purifying solar power, large corporations do not block access in developing countries... See Stuart Hart

# High vs. Low rates, again

Terminology: Islamic finance bans interest on loans, operates entirely on fees, cash 2% advance less than 100%.

1. High: credit when you need it most: everyone needs credit, especially the poor— a human right?
2. High: Small loans, high costs, high interest rates?
3. High: Free market moneylenders worse
4. Low: social Justice caps reassure public...
5. High: Agency problems: asymmetric information
6. High: Limited liability: the tyranny of collateral
7. Low: Adverse selection: risky borrowers
8. High: Supervision/monitoring (NGO's can do this?)

# The IPA-JPAL\* critique of MFI's & other Aid:

1. The poor are must not be hungry because they do not spend extra income on calories (Banerjee & Duflo chapter 2, “A billion hungry people?”) – but there are millions of underweight and stunted children?
2. Without randomized trials (RTS) we do not know what really works to reduce poverty, malnutrition, illiteracy, etc. (example: microfinance) “gold standard” evaluation
3. Traditional economic analysis of aid and credit and malnutrition needs to take into account corruption and irrationality– people do not always do what is good for them or their children, and this applies even more to the poor (harder to make good choices) 2015 [MFI evaluation summary](#) \*[Abdul Latif Jameel Poverty Action Lab-aka JPAL](#)

# Are RCTs the Gold Standard, Deaton, 2009 recent experiments flawed? (even J-Pal - DFID).

“in ideal circumstances, randomized evaluations of projects are useful for obtaining a convincing estimate of the average effect of a program or project. The price for this success is a focus that is too narrow to tell us “what works” in development, to design policy, or to advance scientific knowledge about development processes. Project evaluation using RCTs is unlikely to discover the elusive keys to development, nor to be the basis for a cumulative research program that might progressively lead to a better understanding of development.” [Angus Deaton, 2009, Randomization in the tropics, and the search for the elusive keys to economic Development, Princeton University, See also DFID 2010 Review evidence positive or negative is not strong](#)

# Problems with microfinance or direct lending as at Kiva.org or wholeplanet.org:

1. In most randomized trials microfinance does not reduce poverty much (Hyderabad, J-PAL experiments see pages 72-79 in Karlan and Appel, 2011)
2. Mohammed Yunus: interest rates are too high 30% should be limit (plus inflation) moneylenders replaced with MFI money lenders.
3. People use funds for consumption not investment. If people cannot afford to save, they cannot afford to borrow either.
4. Kiva.org can mislead regarding direct lending, goes to agency see KA, 2011, p. 15-16, 75, 139.

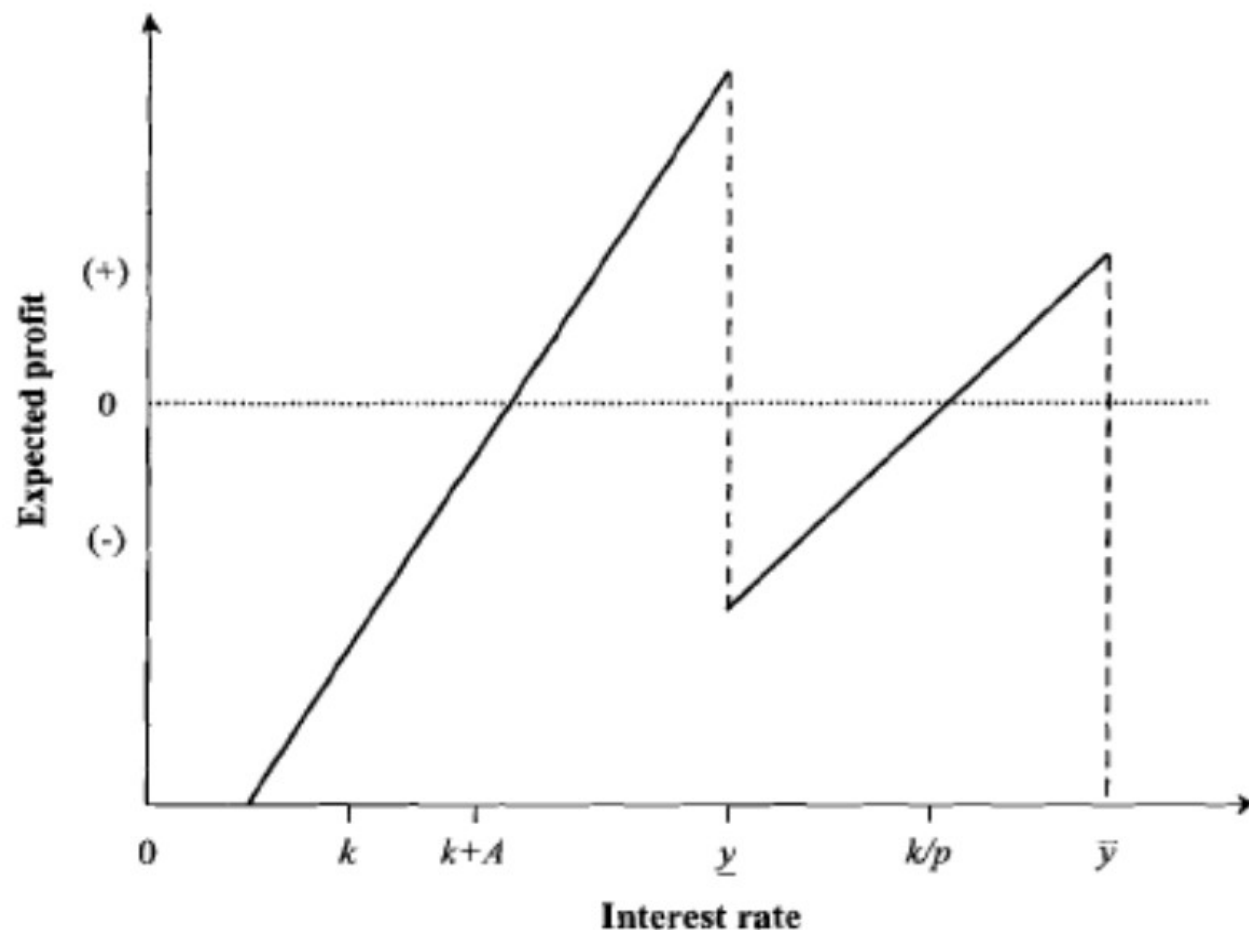
\*Abdul Latif Jameel Poverty Action lab or JPAL



# In defense of microfinance, direct lending :

1. Some evidence microfinance works in BGD “10 million borrowers can’t be wrong” see [Pitt’s reply to Roodman and Morduch](#).
2. Ananya Roy BGD consensus: Social protection + microlending works as part of social protection system... NIDAN, ASA, BRAC & Grameen all part of social protection scheme, NGOs.
3. Even at high interest rates, loans reduce Poverty (South Africa experiment, see Karlan and Abel, 2011, p. 44-51, 64-66)
4. Individual lending better (Grameen II) is ROSCAs (rotating savings and credit associations) Tandas, KA, 2011 p. 92-98.
5. Strong evidence that MFIs smooth consumption over time see Morduch lecture (A&M, 2010 Chapter 9) even if they do not reduce poverty
6. New technologies add potential for savings instead of borrowing, MPESA, micro savings

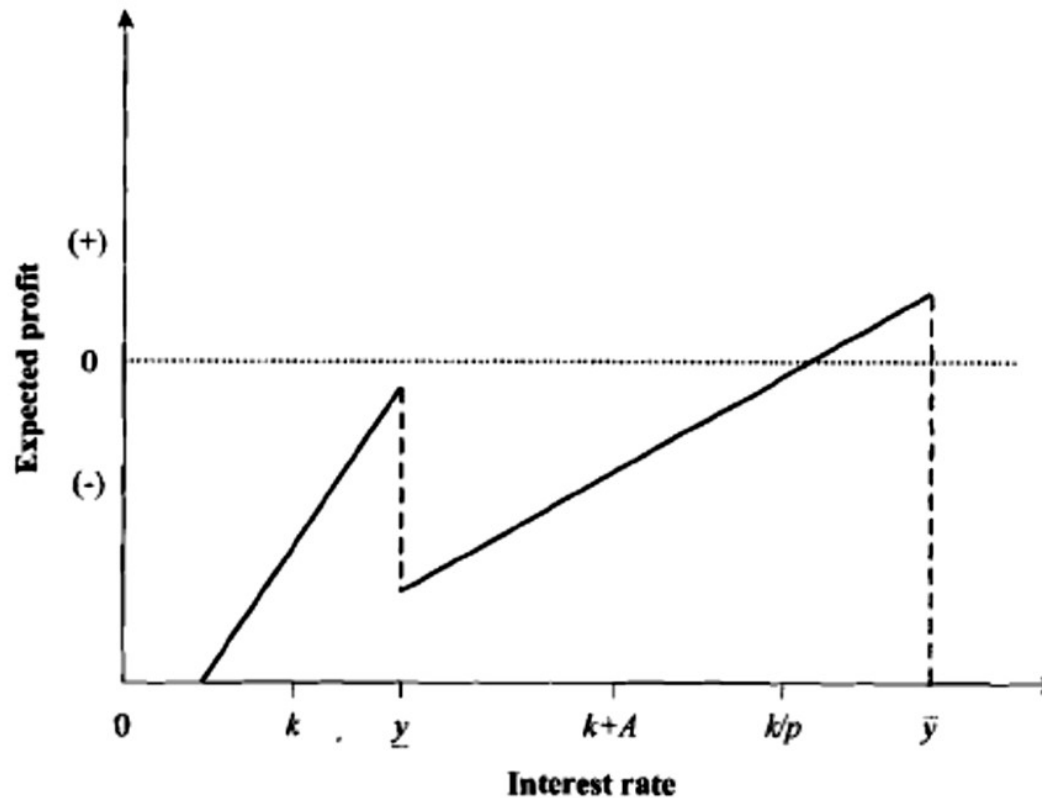
Adverse  
Selection  
creates 2  
equilibrium  
one prices  
out “normal  
borrowers  
(not poor)



**Figure 2.1**

Adverse selection example (a). At gross interest rates between  $k + A$  and  $\underline{y}$  the bank earns a profit and both safe and risky types want to borrow. Safe types leave the market once interest rates rise above  $\underline{y}$ , and the bank loses money. Once gross interest rates are pushed up to  $k/p$ , the bank can again earn profit, while serving only risky borrowers. At gross interest rates above  $\bar{y}$  even the risky borrowers leave the market.

# All risky (poor) borrowers



**Figure 2.2**

Adverse selection example (b). Here, the “risky” types are riskier than in example (a) in figure 2.1. Now the “safe” types can never be served by a bank aiming to break even (since profit is negative even at interest rate  $\bar{y}$ ). The bank must raise gross rates to  $k/p$  to earn profit, at which price the bank will only attract risky borrowers. At gross interest rates above  $\bar{y}$ , the risky borrowers leave the market.

# **Realizing the Promise of Microfinance: “the Bangladesh Consensus”**

**Professors McLeod and Fuentes**  
**Econ & Socio 5808, Summer 2015**

# Graduation from Poverty 2015 MIT News office with pdf for :

Banerjee, A., Duflo, E., Goldberg, N., Karlan, D., Osei, R., Parienté, W., ... & Udry, C. (2015). A multifaceted program causes lasting progress for the very poor: Evidence from six countries. *Science*, 348(6236), 1260799.er



## A “graduation” from poverty

11/27/2017

Study: Anti-poverty intervention provides sustained boost



# Six step graduation plan tried in six countries, worked in five...(except in Honduras where all the chickens died)

1. One time asset transfer, e.g a goat (free).
2. 1 year consumption support food/cash transfer
3. Livestock skills training
4. High frequency home visits...
5. Mandatory savings account, deposit collection
6. Health education or life-skills training

**Examples** BRAC program in Bangladesh and India's Bandhan program.

See [NY Times](#) or [MIT News](#) or [the paper at MIT](#)

# Targeting? Delivery via government, no MFIs need apply, BRAC is an NGO

## Antecedents of the Graduation program

1. Brazil's [goat to school program](#) to end child labor
2. CCTs in Brazil and Ethiopia: "[catching hope](#)"
3. Sen on Women's Agency [BRAC and Grameen](#)
4. David Olds Nurse Home visit program [Elmira, NY](#)
5. [Givewell, Give-Directly](#) one-time grant, unconditional
6. Livestock: Sarah McLachlan 2004 - [World On Fire](#)

# Compare CCTs to Microfinance: or should we combine them? More [slides](#) These slides: [World Bank](#))



## **Growing demand for social safety nets**

Demand for well-designed safety net programs to assist poor families is growing across the developing world, as 2009 develops into a year of tough economic challenges.

Governments are concerned that the financial crisis could turn into a humanitarian one, especially for poor households already hit by the recent food and fuel crises.

# CCTs at Glance (World Bank)

## **Conditional cash transfer (CCT) programs**

CCT programs offer qualifying families cash in exchange for commitments such as taking babies to health clinics regularly or sending children to school.

These programs, now found in over two dozen countries, can reduce poverty both in the short and long term, particularly when supported by better public services.

# CCTs at Glance (World Bank)

Figure 1 CCTs in the World, 1997 and 2008

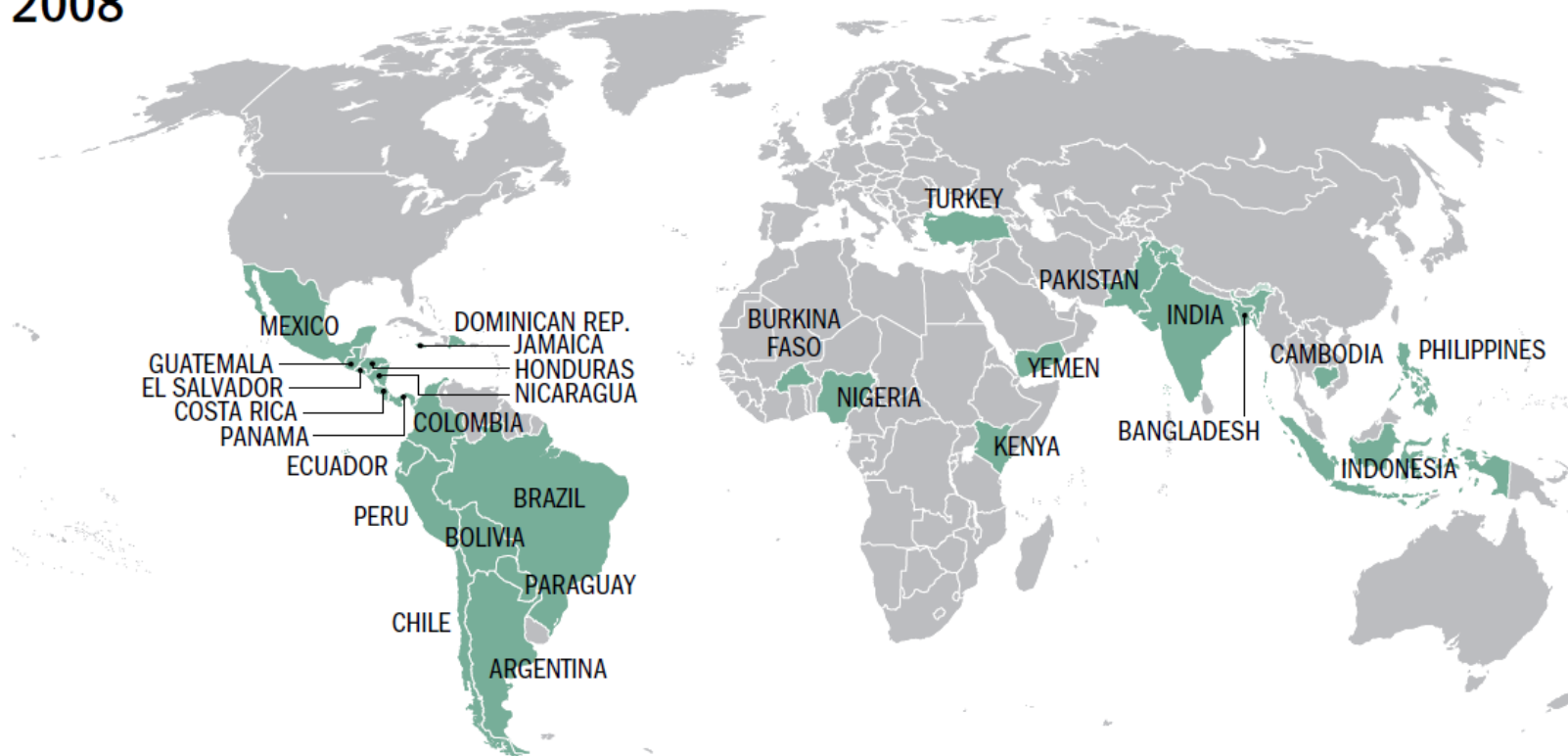
1997





# CCTs at Glance (World Bank)

2008



Source: World Bank.

# Microcredit NIDAN video

Nidan the NGO which has many programs



# Microcredit NIDAN video

- See voices of the
- Sen, A 2008, Development as Freedom, [Women's Agency, Chapter 8](#). Banerjee, Abhijit, Dean Karlan, and Jonathan Zinman. 2015. "Six Randomized Evaluations of Microcredit: Introduction and Further Steps." *American Economic Journal: Applied Economics*, 7(1): 1-21. **DOI:** 10.1257/app.20140287
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- Erica Field, 2014 [the promise of microfinance..](#) Duke University

<http://www.nytimes.com/2012/04/24/business/global/in-bangladesh-strong-promise-of-economic-growth.html?pagewanted=all>

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Angelucci, Manuela, Dean Karlan, and Jonathan Zinman. "[Microcredit impacts](#): Evidence from a randomized microcredit program placement experiment by Compartamos Banco." [American Economic Journal: Applied Economics](#) 7, no. 1 (2015): 151-182.

J-Pal and IPA [Policy Bulletin \(2015\) Where credit is due](#): *Seven randomized evaluations from around the world show that microcredit does not have a transformative impact on poverty, but it can give low-income households more freedom in optimizing the ways they make money, consume, and invest.*

Suri, Tavneet, and William Jack (2016). "[The long-run poverty and gender impacts of mobile money](#)." *Science* 354, no. 6317: 1288-1292.

**Ricardo Hausmann\*** *Finance & Development*, June 2010, Volume 47, Number 2 Book Review, *Review of Muhammad Yunus, Building Social Business The New Kind of Capitalism That Serves Humanity's Most Pressing Needs* Public Affairs, New York, 2010, 226 pp. \*head of Harvard CID & former minister of Industry in Venezuela. [To Profit or Not to Profit: Is That the Question?](#) [PDF version](#)