

Credit, Consensus & Confusion

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The word “microcredit” did not exist prior to the 1970s, but in the past few decades, microcredit programmes implemented across the developing world have burgeoned, offering a new method by which we can tackle the issue of poverty. Cillian Bissett dives into this ever-expanding field of research, offering a comprehensive summary of findings in the literature to date. As is illustrated, the impact of microcredit programmes in developing nations is still somewhat ambiguous, with significant dissonance within the literature, yet as time wears on and the research output increases, we appear to be coming closer to a consensus on the benefits and drawbacks of microcredit programmes. That being said, further research undoubtedly must be undertaken to gauge the success of microcredit as a means of alleviating poverty across the globe, and more than just economic factors ought to be considered when conducting such research.

I. Introduction

There is a growing body of evidence suggesting the impact of microcredit can be more complicated than intuition may suggest, particularly in terms of the ability of small-scale loans to reduce poverty. The dissonance within the literature across settings clearly indicates that further research is needed, in spite of emerging trends within recent findings.

The Need for a Loan

Microcredit was originally conceived as a means to tackle poverty, by means of extending financial services to tackle those as-

pects of the poverty cycle which may be linked to credit constraints. Critically, it serves as a means to give credit in a financially sustainable way to those people who would have little or no access to formal credit. The institutions one would think of as providing “formal” credit are essentially banks. Formal lenders operating in relatively less well-off countries tend to serve the wealthier portion of the market; institutions providing credit tend to have relatively strict requirements, especially due to requiring collateral which the less fortunate simply cannot provide, shutting them off from one of the main sources of credit in a given economy. Hence, an alternative was needed.

Muhammad Yunus conceptualized this idea in the Grameen Bank. The basic principle was that small loans would be provided to each of a small group of borrowers. If even a single borrower within that group were to default, none of the recipients would be eligible to receive any microcredit in the future. This incentivizes two key changes in behaviour. Firstly, people will essentially screen their own groups to ensure they are only with people who they view as reliable, which overcomes the information asymmetry that exists between lenders and borrowers. Secondly, it encourages members of groups to monitor the use of the funds, to ensure they are put to the use for which they were originally given out. This lending mechanism has several variants, such as sequentially offering the loans to members of a group, and some microcredit providers actually offer products to individuals. At the very least, it seems Grameen Bank was successful, having loaned almost \$29.04bn from the inception of the programme (Grameen Bank, 2020). Moreover, Yunus, the architect behind the programme, was awarded the 2006 Nobel Peace Prize. That said, while we can see that the schemes are at least sustainable, and seem to be helping a large number of people, can we find evidence that this is indeed going to be key in eradicating poverty globally?

To fully understand the issues facing the sector, it is necessary to have a clear-cut picture of the market as it stands today. Microcredit is a key area of growth within the international banking sector. In 2018, 139.9 million people directly benefited from microcredit, as compared to 98 million in 2009, with an average annualized growth rate of 11.5% over a 5-year period (convergences.org). The total outstanding loan portfolio had a total value of \$124bn, with approximately 80% of all borrowers being female, and 65% of all borrowers living in rural areas. The market has several leading areas: namely, South America and Southeast

Asia. South America has the biggest market according to portfolio value, at \$48.3bn, whilst Southeast Asia dominates when measured by the number of people availing of microcredit, with 85.6 million people availing of microcredit in 2018 (a growth rate of almost 14% on the previous year). Furthermore, Southeast Asia is the location of the three countries with the largest numbers of borrowers: India, Bangladesh and Vietnam. A key idea to take note of is that microcredit is being pushed in two ways: firstly, as means of female empowerment (recall the fact that 80% of borrowers are female), and secondly, as a means of helping poorer rural communities (also recall that 65% of borrowers are rural dwellers).

Effects on Service Users

The first item to focus on in attempting to settle the debate: what can microcredit do for those who avail of the service? There are quite a few studies suggesting that there may be a role for microcredit in helping to alleviate poverty, or at least in addressing certain symptoms of poverty. Evidence has been found indicating positive net impacts on the borrowers in question on a wide variety of outcomes (which have typically varied significantly by setting) such as consumption, economic self-sufficiency, outlook, and mental health being positively affected in South Africa (Zinman & Carlan, 2015), which were brought about by use of microcredit to pay off debts (28.3% of overall use), with transport and other work-related expenses being the next most common usages. In other settings, small business investment, business profits, and durable good consumption increased in Hyderabad, India (Banerjee et al., 2014), with similar effects being detected in other settings such as Morocco (Duflo et al., 2011). Clearly, seeing such variability in what outcomes we see affected suggests two things; firstly, impacts of microcredit are clearly context-dependent. Secondly, microcredit may have the potential to affect a vast array of outcomes, provided it is enacted in a particular manner. Indeed, papers trying to identify causal channels have concluded that the channels through which microcredit acts will vary by the country's income (Maksudova, 2010), and that the impact also varies by gender of the recipient (Khandker, 2005).

There has also been indication within the literature that perhaps the effects are not all positive. The aforementioned study in Hyderabad found non-durable consumption actually fell, rather than increased (due

to increased likelihood to save to complement the loan). In some cases grace periods are provided, where loan repayment does not immediately commence upon receipt of the loan. This suggests that we see the recipients being encouraged to cut back consumption on a day to day basis - while the extra savings may help them create more value from the loan, this could have a substantial negative impact on their welfare, particularly in cases where essentials are being sacrificed in order to complement the loan. Furthermore, while we see higher investments into businesses and profit growth, there are also higher default rates (Field et al., 2013). Thus, one can conclude that it may be preferable for providers to have no grace periods, to ensure careful use of funds; this in turn would reduce the investment into businesses (particularly those of a risky nature), mitigating at least in part one of the purported benefits of microcredit programs in terms of boosting entrepreneurship.

It is not unreasonable to suggest that in many cases where microcredit has been successful, the positive impacts may have stemmed from unmet demand in the market. One of the basic ideas underpinning microcredit is that those who avail of small loans may not have access to credit from other sources outside the informal market. Empirically, it has been found that expansion of microcredit did not seem to crowd out other forms of lending, suggesting there is essentially untapped demand in these markets (Carlan & Zinman, 2011). This is encouraging as it supports the principle of credit rationing: that is, for a given interest rate, borrowers in these markets will want to borrow more than they are offered. Unfortunately, even where it seems there was a supply constraint there were no clear positive impacts on the number of businesses operated or on the number of paid employees working for a household. Indeed, the effects amongst the treatment group were slightly negative, significant at the 10% level. Further negative effects were uncovered on subjective well-being, at a 10% significance level. Admittedly, while this is not as strong an indication as we may like, it is well worth bearing in mind and is still highly likely to be non-random.

Turning our attention from income, personal finances and entrepreneurship to emotional wellbeing, we get a slightly bleaker picture. Poor rural women in Bangladesh reported depression-like symptoms, with microcredit doing nothing to ease emotional stress. This was often due to new roles women found themselves in within the household (Ahmed et al., 2001), which ought to be weighted particularly heavily in any judge-

ment of the market, as women are the biggest market segment, followed by rural dwellers. Case studies have found borrowers can be protected from peer-pressure induced stress in group lending situations through the use of flexible repayment options, offering savings facilities, and short duration consumption loans with high interest rates (Montgomery, 1996). That said, evidence has been found that receipt of microcredit makes the recipient a generally more responsive and active agent, both financially and more broadly in their own lives (Basher, 2007). Worth noting, Basher's discussion of spill-over effects refers to effects upon nonfinancial aspects of a person's life, not spill-over effects upon non-recipients.

Methods matter

One issue of particular concern is the way in which microcredit is practiced, as cases of malpractice have been seen to have serious detrimental effects upon recipients. One of the more prominent cases of this can be seen in southern India in 2010. Here, lending behaviours were reported within the media to have mirrored those within the US property market, and lead in turn to a suicide epidemic due to financial stress within the Andhra Pradesh region (Biswas, 2010). Collins et al. (2009) suggest that the type of Micro Finance Institutes that are savings-driven rather than credit-driven yield better outcomes for borrowers. In this case, India's regulatory environment did not permit MFIs to provide savings products, which have been identified to be a key element of providing microcredit. Indeed, the absence of savings products has been suggested to have been a key component in causing the issues seen in India at that time (Schmidt, 2010). As the borrowers had no savings facilities on offer, it was substantially more difficult to manage one's finances. This in turn meant it was more difficult to meet repayment obligations to the lender. Indeed, providing microcredit and a savings facility is valued very highly by the service users, who typically accept very high interest rates, and are willing to take little to no interest on their savings. In fact, cash flows into and out of these accounts can range from 75% to 500% of a household's annual income (Rosenberg, 2010).

Furthermore, there is a big ethical question hanging over the fairest method for group lending - the debate pits simultaneous against sequential lending. Sequential lending means subsets of a borrowing group are given their loans first, and as they repay, loans are extend-

ed to other members of the group over time. Should an earlier recipient fail to pay back a loan, members of the group who have yet to receive any financial aid will still be blacklisted and unable to avail of such services in the future. In the simultaneous case, though they will still be blacklisted, they will still have received their loan, and had the opportunity to set up a business. In principle, justification offered for sequential lending is that withholding the loans to some members of a group conditional on others repaying creates greater social pressure to pay back, enabling the credit provider to serve more people.

The communal impact

Spill-over effects are rarely examined in great individual detail in the context of microcredit. Where they have been examined, it has been looking at villages that did not receive any program benefits and drawing comparisons to those that did. In these cases, spill-over effects were typically scarce and, where they existed, were typically small, such as only hiring approximately 4 extra days of labour during agricultural season (Beaman et al., 2014), which is asserted to be quite small and unlikely to affect output in a meaningful way.

One of the few advances in examining spill-over effects came from treating the credit market as having two sectors and adverse selection, and showing that real world data fit the behaviour predicted in the model. In particular, under some circumstances increases in the interest rate charged to people outside of the microfinance sector were triggered, which could harm the welfare of those borrowers (Demont, 2013). Specifically, this can occur when safe borrowers can get access to individual loans and microfinance providers are unable to serve the entire market. Clearly, this indicates the market conditions and financial health of the microfinance providers are key in determining the nature of the spill-over effects.

Spill-over effects have been detected on poverty and female empowerment at a municipal level within Bolivia (Gonzalez et al., 2018), with spill-over effects on poverty corroborated by the aforementioned 2005 paper by Khandker. Indeed, Karlan, Goldberg and Copestake state unambiguously that RCTs are the best possible approach to evaluating the impact of microfinance programs (Karlan et al, 2009). Note that many previously-referenced studies used a random phase-in approach

Conclusion

Given a lot of conflicting evidence, it can be quite difficult to infer what the “true” impact of microcredit is. Surveys of the literature, across different settings, have reached the conclusion that while positive impacts should be expected, these are typically small, and rarely transformative as some would claim (Banerjee et al., 2015, Develtere et al., 2005), with papers examining a variety of outcomes suggesting they do some good with minimal negative effects (Angelucci et al., 2013). We can safely claim we are approaching some sort of loose consensus on the direct impacts of microcredit, with the emergence of certain trends amongst the recent literature and consumers voting with their feet and signing up en masse.

That said, we cannot truly claim the effects are particularly clear-cut, as there are still a number of studies which have found neutral or negative effects. Furthermore, there is a strong case to suggest the emotional & psychological impacts may be negative, especially in cases where the service is implemented in a manner that is not consumer friendly. Thus, to truly discuss the impact of microcredit, an age-old question must be grappled with: how should we measure the success of microcredit? It is fair to claim on the basis of the available evidence that microcredit can be, but not always, successful at helping tackle financial issues related to poverty. Considering happiness, emotional well-being and psychological impacts yields a much darker view. Is this unique to microcredit as a solution to poverty? Not necessarily, but to finish the debate once and for all, further research on this aspect is necessary. One thing alone can be stated with absolute certainty: these small loans can have a very big impact.

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