

Microfinance: controversies and new directions

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Economics & Sociology 5808, Summer 2012

Microfinance: a rough five years



- 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 documentary accused him of mishandling a \$100 million grant (see NY Times 2011 [Microlenders honored, now struggling](#))



* The Nobel Peace Prize 2006". Nobelprize.org. 14 Jun 2012
http://www.nobelprize.org/nobel_prizes/peace/laureates/2006

What is Microfinance? Mainly from excellent review by Karlan and Goldberg (2011) chapter 1 of HOM

- (1) Small transactions and minimum balances (whether loans, savings, or insurance).
- (2) Loans for entrepreneurial activity.
- (3) Collateral-free loans.
- (4) Group lending (Grameen I)
- (5) Focus on poor clients.
- (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, now self help groups*
- 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](#) ;*

Bad news from Andhra Pradesh



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



Microfinance Controversies old and new

1. *High interest rates, growing pains (aggressive collection violence?) fuels IPOs but Yunus calls Compartomos et. al. moneylenders... wants cap of 25% or 10-15% spread*
2. *Some 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).

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)

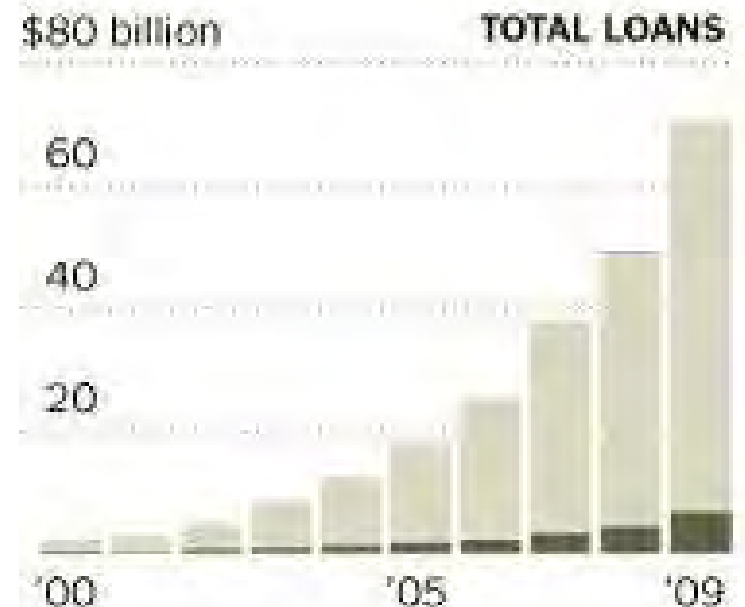
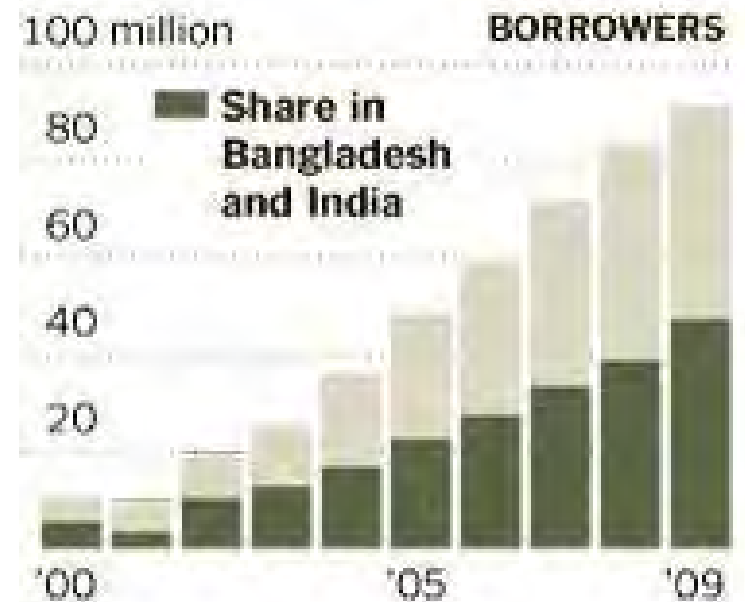
Defenders of MFIs

- 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

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*

1. **Access to credit is a human right** (with or w/o cap?) Safe savings vs. borrowing
2. Microfinance key component of a **broader social safety net**... examples ASA, BRAC and Grameen (also Nidan in India) + development strategy.
3. **Public vs. Private transcript:** Microfinance is self-financing and profitable, but this is basically wrong— **private transcript** embeds microfinance as part
4. The subsidy component of Microfinance runs about 30%: about 70% operations self financed (Morduch's thesis).
5. Grameen II shares some common ground with Accion move from group to individual lending... + savings.

*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 %
- 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

Normal borrowers (not poor)

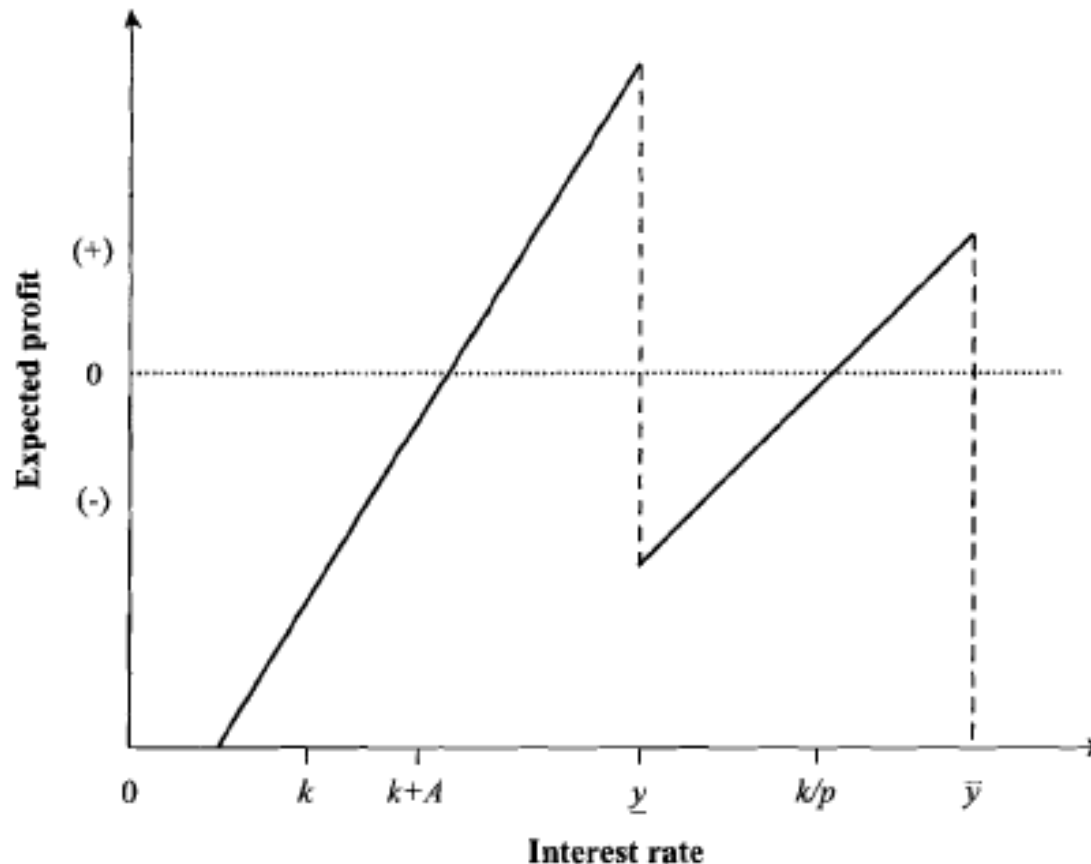


Figure 2.1

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

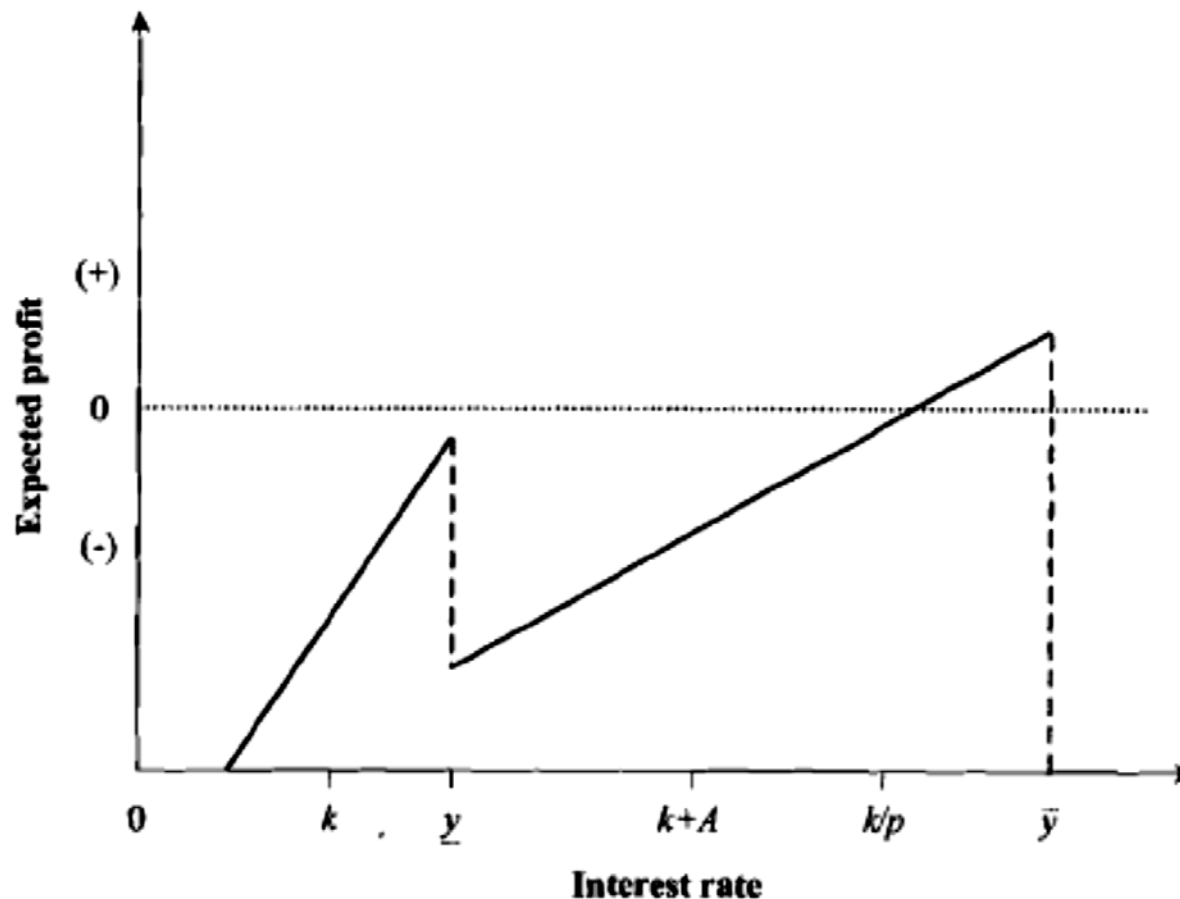


Figure 2.2

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 \underline{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.

How best to reduce cost of borrowing?

1. Obvious is caps: lead to other problems: ration credit of credit, relabeled fees, overdraft charges
2. Spread cap better, but hard to explain or enforce .
3. Reduce asymmetric information: credit reports, APR groups...
4. Increase competition in loan market (multiple loans?)
5. Give poor collateral (De Soto's idea, tyranny of collateral—Rajan and Zingales, a pound of flesh)
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)

High vs. Low interest rates, again

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...
4. High: Agency problems: asymmetric information
5. High: Limited liability: the tyranny of collateral
6. Low: Adverse selection: risky borrowers
7. High: Supervision/monitoring (NGO's can do this?)

High interest rates are cost of doing business with poor families...

1. High cost of borrowing (even interest-free loans from family) makes safe, private savings very worth while, but can they save? Yes see Collins et al. 2009 Portfolios of the poor, [Appendix](#) and [Chapter 5](#) the price of money (and [footnotes](#)).
2. People should save (and eat well) but they (we) often don't... Behavioral economics is about these problems, see [Karlán & Appel volume](#), microsavings with reminders.
3. How to attract poor savers (and how much the poorest can save) is the story of Grameen II ([Chapter 6](#) of Collins et al. 2009 portfolios of the poor....

Grameen II shows poor can save

1. Grameen I started in 1976 by economics professor Mohammad Yunus* BRAC & ASA imitate
2. 1998 floods greatly reduced Grameen I repayment rates (98% to 74%) Grameen bank shrank
3. Grameen II or the Generalized system replaced single type of loan (1 yr) and repayment (equal weekly payments) more flexible loan p.157*
4. Compulsory group liability and weekly saving deposit dropped, interest paying personal passbook savings (BURO commitment savings— too raise capital depleted by flood losses. P. 158*

*See [Portfolios of the Poor Chapter 6.](#)

Grameen II diaries show how poor save

1. Rutherford et al. visit households once every month for three years 2002-2005 include some households who are not microfinance members
2. Poorest households use loans to deal with fluctuations in income and expenses, smooth consumption, no “productive” investment, but loans still essential (Ramna p. 164* used \$200 loan for school fees, medicine, funeral and grain)
3. Passbook savings feature of Grameen II used extensively by poor households... Grameen went from MFI-NGO to retail bank 4. P. 159* *See [Portfolios of the Poor Chapter 6.](#)

Grameen II Diaries Source of loans

Table 6.1 Grameen II Diaries: Total Disbursed Value of Loans, by Source

	<i>Value of loan</i>	<i>Percentage of total loans taken</i>
Interest-free loans from family & neighbors	15,989	23%
Credit advanced by shop-keepers	1,692	2%
Loans on interest from family, neighbors & moneylenders	9,033	13%
Loans from savings-and-loan clubs	2,468	3%
Loans from formal banks	2,167	3%
Loans from microfinance institutions	39,668	56%
Total	\$71,017	100%

Note: US\$ converted from Bangladesh takas at \$ = 60 takas, market rate. The table includes all loans, not just microfinance loans, both outstanding at start of period and taken during period for all 43 Grameen II diarists.

**See Portfolios of the Poor Chapter 6.*

Grameen II Diaries use of loans

Table 6.2 Grameen II Diaries: Number and Disbursed Value of Microfinance Loans, by Use Category

	<i>Number</i>	<i>%</i>	<i>Value (US\$)</i>	<i>%</i>
Stock for retail or trading businesses and crafts	75	32%	15,231	39%
Asset acquisition and/or maintenance	37	16%	5,583	14%
On-lending to others outside the household	27	11%	5,764	14%
Paying down other debt	25	11%	3,413	9%
Consumption	18	8%	1,425	4%
Mixed uses	55	23%	7,535	19%
Total	237	100%	38,951	100%

Note: US\$ converted from Bangladesh takas at \$ = 60 takas, market rate. A total of 239 microfinance loans were used by 43 borrowers. The two loans unaccounted for were placed into savings instruments.

**See Portfolios of the Poor Chapter 6 p. 166*

Grameen II diaries key findings

1. About 60% of loans from MFIs, about 53% of loans used for “productive” investment
2. Just 6 of 43 households take $\frac{3}{4}$ of business loans (about 11,000 of 15,000 in loans, Table 6.2)
3. So microfinance not mainly used for business enterprises... (may not reduce poverty much)
4. Most take loans from several microfinance providers (successful businesses) one use \$4000 in loans for grocery store
5. Even long term savings, Grameen Pension Savings (GPS)
6. P. 169 [Portfolios of the Poor Chapter 6.](#)

Grameen III going

1. Grameen Diaries point to need for more flexible MFIs: loans, passbook savings and commitment savings can all play key role.
2. Mission drift or scaling up? groups not essential, weekly meetings not essential, focus on women not essential (sounds more like Latin American model?).
3. Offer a range of financial services, micro insurance, pension savings, etc. Flexible credit lines not fixed rate and payment loans P. 172-172 [Portfolios of the Poor Chapter 6.](#)

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, moneylenders replaced with 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

But RCTs not 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

In defense of microfinance, direct lending :

1. There is some econometric evidence from Bangladesh that microfinance works (BGD is doing well, 10 million borrowers can't be wrong) see [Pitt's reply to Roodman and Morduch](#).
2. Ananya Roy: Social protection + microlending works best private transcript: part of social protection system... ASA, BRAC & Grameen all part of social protection scheme (not real banks).
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 (Grameen II) is more reliable ROSCAs (rotating savings and credit associations) Tandas, KA, 2011 p. 92-98.
5. Strong evidence that MFIs smooth consumption over time (A&M, 2010 Chapter 9) even if they do not reduce poverty(wrong measure of poverty, vulnerability reduced)
6. But what about Micro Savings?

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

1. Without randomized trials (RTS) we do not know what really works to reduce poverty, malnutrition, illiteracy, etc. (example: microfinance), they are the “gold standard”
2. Traditional economic analysis of aid, credit, education, does not anticipate teachers who do not teach or irrationality of poor— people do not save or take care of their children (vaccinations, bed-nets) perfectly, none of us do but especially the who have much harder life (& little income)
3. 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?

*[Abdul Latif Jameel Poverty Action lab or JPAL](#)

New technologies getting rich selling to the poor, mobile banking, etc.

Export market as opposed to small services & retail:
new sewing machines, tractors, tube wells, etc.

Mobile money, branchless banking, the end of a dangerous cash economy... remittances costly and lumpy... less so with mobile phones— see the economics of M-PESA

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

Compare CCTs to Microfinance: or should we combine them?([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)

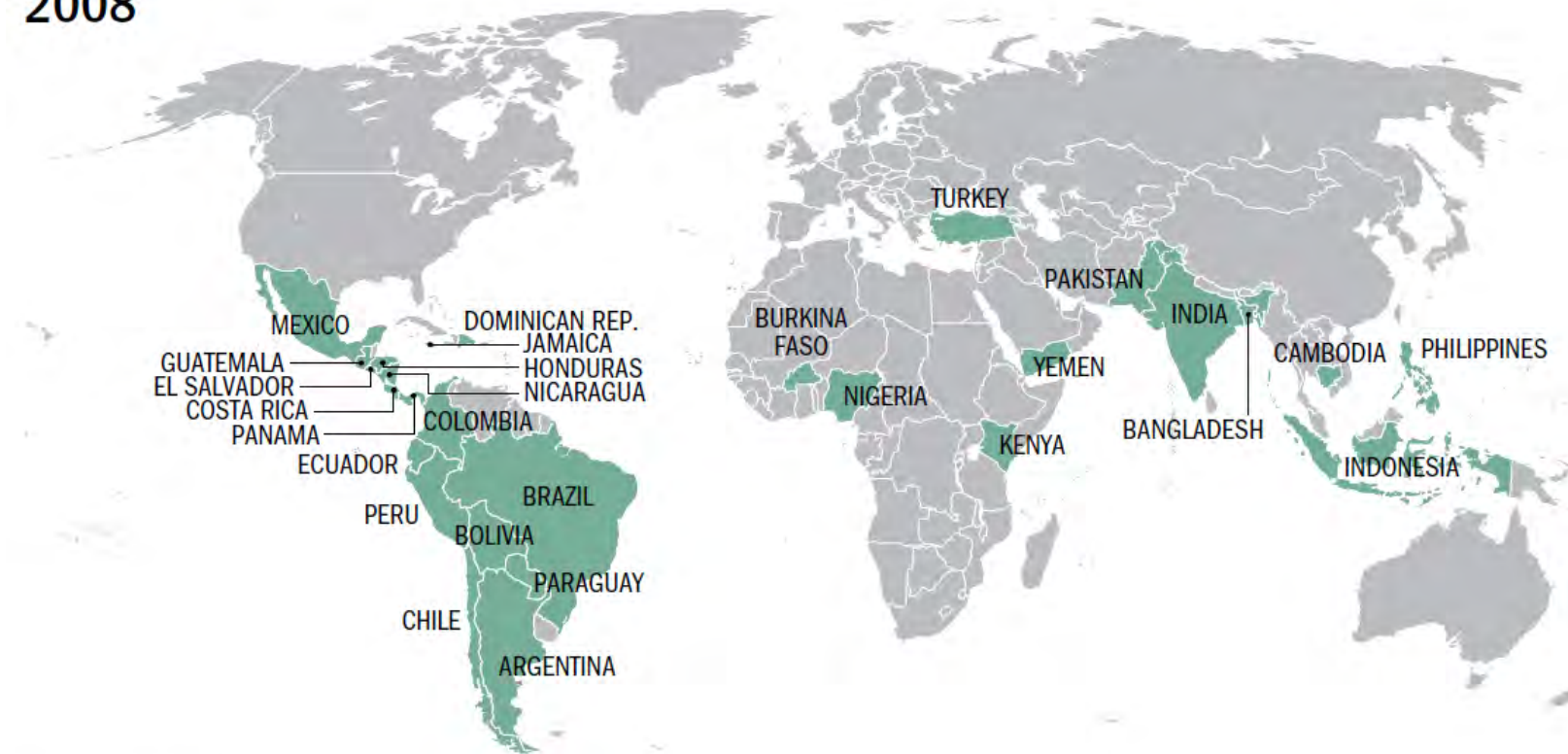
Figure 1 CCTs in the World, 1997 and 2008

1997



CCTs at Glance (World Bank)

2008



Source: World Bank.

Microcredit NIDAN video

- So when you show the YouTube video in class please make sure that you show this attached clip so that you can see the actual correct closed captioning:

http://www.youtube.com/my_videos_timedtext?video_id=hdbd7zxpj1o&feature=vm#

- <http://www.fordham.edu/economics/mcleod/microcredit.mp4>

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

Campus MFIs

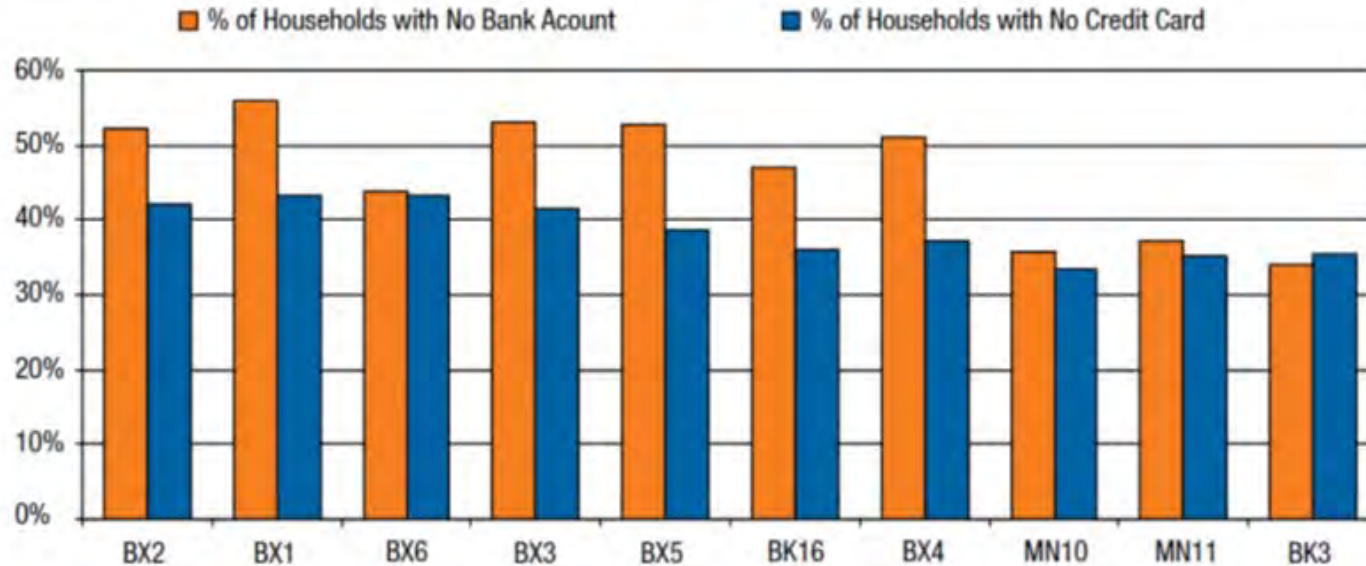
Table 1: Selected East Coast Campus Microfinance Alliance members

Campus MFI Fund	University	Start Date	Clients Served	Student Staff	Annual Budget	Funding Sources			
						Private	Public	Univ	Earn
Capital Good Fund	Brown	2008	95	20	180,000	75	18	0	7
Community Empowerment Fund	NCU, Chapel Hill	2009	80	70	38000	81		19	
Elmseed Enterprise	Yale University	2001	68	30	8000	59		33	8
Intersect Fund	Rutgers Univ.	2008	159	5	800,000	45	50		5
Average			101	31	256500	65	34	17	7

Source: Campus Microfinance Alliance, (see Appendix A) <http://www.campusmfi.org/index.html>
 For additional information, see http://www.gdsnet.org/CMA_Microcredit_profiles4.pdf

The bronx

Chart 1. 10 Lowest-Income NYC Neighborhoods: Banking and Credit Card Access



Neighborhood Legend

BX1= Bronx Community District 1 (Mott Haven, Melrose, Port Morris)

BX2 = Bronx Community District 2 (Hunts Point, Longwood)

BX3 = Bronx Community District 3 (Melrose, Morrisania, Claremont, Crotona Park East)

BX4 = Bronx Community District 4 (Highbridge, Concourse)

BX5 = Bronx Community District 5 (Morris Heights, University Heights, Fordham, Mount Hope)

BX6 = Bronx Community District 6 (East Tremont, Bathgate, Belmont, West Farms)

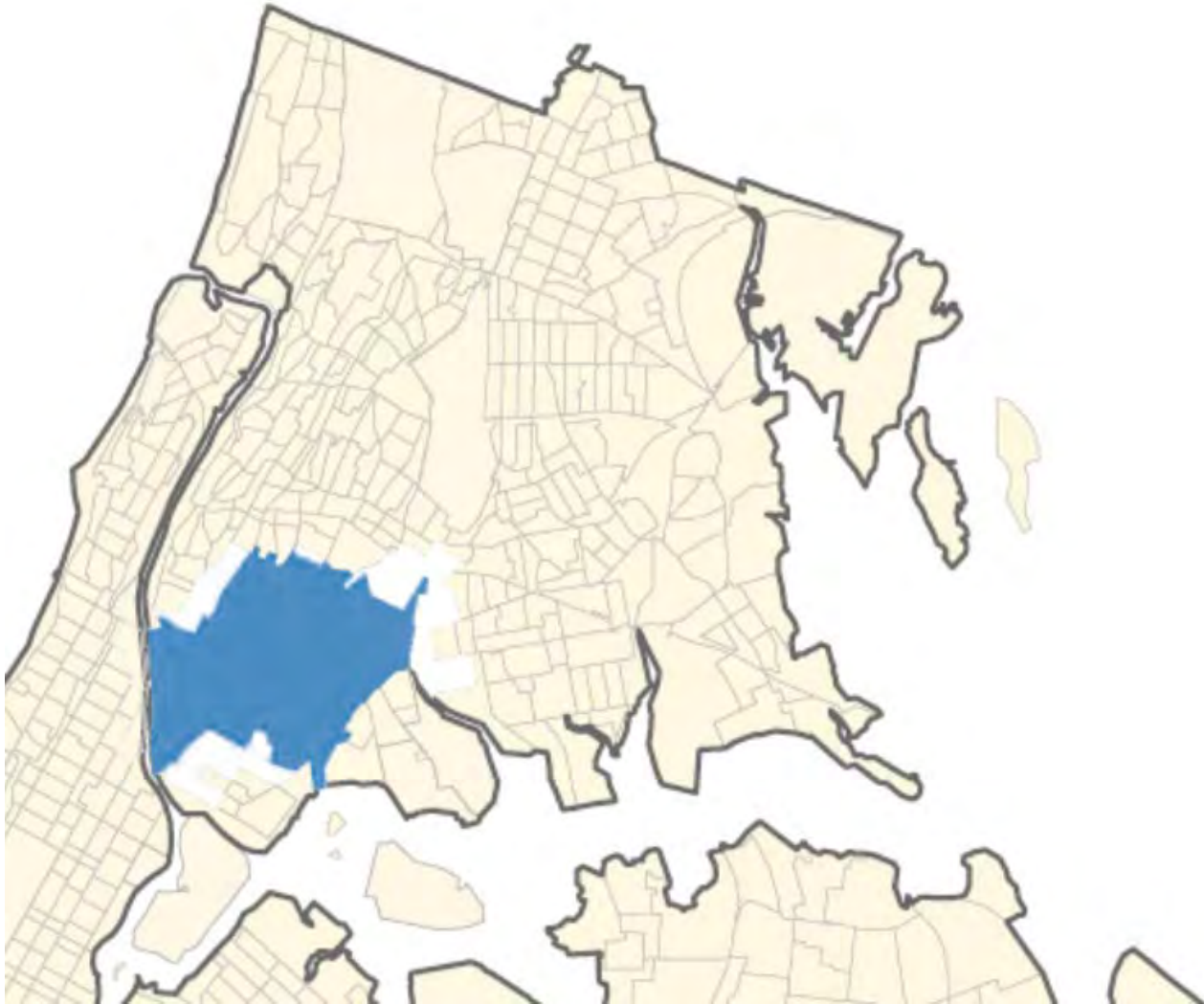
BK3 = Brooklyn Community District 3 (Bedford Stuyvesant, Tompkins Park North)

BK16 = Brooklyn Community District 16 (Ocean Hill, Brownsville)

MN10 = Manhattan Community District 10 (Central Harlem)

MN11 = Manhattan Community District 11 (East Harlem)

The Bronx NFS study



The Bronx

Table 4. Bank branches, credit unions, and check cashers per 10,000 residents

Region	Banks and Credit Unions	Check Cashers	Remittance Agents*	Pawnbrokers	Rent-to-Own
New York City	2.00	0.50	5.31	0.20	0.04
Bronx	1.08	0.77	7.47	0.49	0.07
Melrose	0.82	0.93	8.17	1.08	0.15
Brooklyn	1.28	0.49	5.07	0.12	0.04
Manhattan	4.52	0.62	5.45	0.33	0.03
Queens	1.87	0.46	5.62	0.08	0.04
Jamaica	0.78	0.71	4.60	0.12	0.06
Staten Island	2.23	0.11	4.33	0.07	0.07
Population estimates from 2000 Census					
*Remittance agents include all licensed money transmitters other than banks, credit unions and check cashers.					
Sources: Federal Deposit Insurance Corporation (2006); New York State Banking Department (2007); National Credit Union Administration (2007); U.S. Census (2000); Rent-a-Center (2007)					

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