

Microcredit doesn't live up to promise of transforming lives of the poor, six studies show

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Microcredit—providing small loans to underserved entrepreneurs—has been both celebrated and vilified as a development tool. Six new studies from four continents bring rigorous evidence to this debate, finding that while microcredit has some benefits, it is not a viable poverty alleviation tool.

The studies, conducted by researchers affiliated with Innovations for Poverty Action (IPA) and The Abdul Latif Jameel Poverty Action Lab (J-PAL), conclude that while microloans can increase small business ownership and investment, the small, short-term loans generally do not lead to increased income, investments in children's schooling, or substantial gains in women's empowerment for poor borrowers.

"The studies do not find clear evidence, or even much in the way of suggestive evidence, of reductions in poverty or substantial improvements in living standards. Nor is there robust evidence of improvements in social indicators," the introductory paper to the studies reads.

The six studies, conducted independently in Bosnia and Herzegovina, Ethiopia, India, Mexico, Mongolia, and Morocco, and released in the *American Economic Journal: Applied Economics*, followed over 37,000 individuals in total. Across all six studies, researchers conducted randomized evaluations in which one group of potential borrowers

received access to microcredit, while the other group received no such offer. By comparing outcomes between these two randomly chosen groups, researchers were able to identify the effect of expanded access to microcredit on business activity, financial behavior, and household welfare. The results showed modest, but not transformative, improvement in the lives and financial well-being of individuals one to four years after they accessed microloans.

All studies found some evidence of expanded [business activity](#), but these investments did not often result in significant increases in profits. In Mexico, for example, where Innovations for Poverty Action (IPA) followed over 16,000 households, those with access to the loans showed increased business revenue and costs, but these did not translate into increased profits or income. In general, microcredit had mixed effects on household income and consumption.

In some instances, however, microcredit did afford people more freedom in how they earn and spend money. In Morocco, borrowers cut back on wage labor as business sales and profits improved. In Mexico, microcredit helped women avoid selling assets to pay off debts.

Results from all six studies show little support for the assumption that microloans, which are often offered to women, increase women's empowerment or investment in their children's education. Researchers found in Morocco, for example, that the loans made no difference in the chances of children being enrolled in school or on a number of women's empowerment measures.

Economist Esther Duflo of the Massachusetts Institute of Technology, a co-founder and co-director of J-PAL, co-author of the India and Morocco studies, and founding editor of the *American Economic Journal: Applied Economics*, said, "These loans do help, but the changes are not transformative, certainly not transformative enough to justify

charitable donations to the standard microcredit model. We have seen, though, that these are viable profit-making products, and so investors interested in a double-bottom line should take note." Duflo suggests researchers and non-profits focus their attention on other approaches for financial inclusion for the poor.

"We must think beyond the standard microcredit model. Modern microfinance—savings and insurance, and more flexible credit products—often has generated larger impacts than simple credit," said economist Dean Karlan of Yale University, founder of Innovations for Poverty Action, and chair of finance at J-PAL, who co-authored the Mexico study. "Financial services can make important differences in people's lives, but we need more innovation and evidence to determine what is best to do, and meanwhile we should set our expectations appropriately," Karlan said.

Provided by Innovations for Poverty Action

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