

The Economics of Microfinance

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MIT Press, Cambridge, Mass., USA

Paperback, September 2007 (2005)

6 x 9, 360 pp., 15 illustrations

ISBN-10: 0-262-51201-7

ISBN-13: 978-0-262-51201-5

Those of us working in development know to be wary of the latest fads. This has naturally led many of us to be cautious of the phrase “evidence-based aid”, popularised most recently by the MIT-based Poverty Action Lab. Evidence-based aid, spearheaded by Michael Kremer, and more recently Esther Duflo, promotes an experiment-based methodology which can be used to assess the effectiveness of development initiatives. Microfinance is particularly suited to such experiments, given that many of the ethical dilemmas that confront the social experimenter are absent in these programs. This book provides a fascinating introduction to the world of evidence-based aid, moreover, it is the first really comprehensive framework for the economics of microfinance. As such, it is a welcome contribution to an industry that has outlived many trends and brought the international marketplace to the poor.

The Economics of Microfinance is a well researched, well written book that is accessible to the practitioner and academic alike. And it doesn't pull punches, tackling the bad with the good and addressing many of the questions some in the industry would rather not ask. Commencing with the motivations for microfinance, it outlines the theory behind the colourful photo-ops with Hollywood celebrities and details the arguments both for and against microbanking. There is no doubt that microfinance is an effective tool for development, and one that has been remarkably successful. But there are also concerns regarding microcredit and the incentives it creates, both within poor communities

and within the development field. There is a question mark hanging over many ventures - are they really as successful as they are portrayed in the glossy marketing material?

The authors are quite frank in their assessment of the success of microcredit organisations, and Chapter 8 (Measuring Impacts) states clearly that there are very few credible and statistically sound studies that demonstrate the effectiveness of microcredit. Spillovers and the difficulties inherent in isolating control groups are part of the problem, issues discussed at length in the chapter. It concludes with an analysis of the research on Bangladesh, finding that while microfinance benefits may be overstated at times, the overall impacts are still positive. But the jury is still out on how applicable these findings are elsewhere in the developing world – leaving plenty of room for innovative, high-quality studies by the enterprising researcher.

Chapter 9 tackles the difficult issues of Subsidy and Sustainability, again highlighting a lack of credible analyses, in this case cost-benefit studies that compare the cost to donors with economic returns to the target community. Rigorous analysis is, of course, not a deficiency limited to microfinance, but to development interventions in general. This chapter also does a good job of discussing some of the challenges when managing subsidies, and details ways to minimise negative incentives while maximising the outcomes of a program. The role that gender plays in the successful implementation of microcredit schemes is outlined in Chapter 7, and details evidence that female borrowers are not just more reliable than male borrowers, they also generate the lowest cost-benefit ratios.

But the book fails to address one pertinent issue, the perception that men are more likely to expand a business outside the home and hence create greater economic growth and employment. While one academic has research to refute this perception – Bruce Wydick, whose 2001 paper with Michael Kevane is cited and who has since published further

on this topic – the complexity of his findings are glossed over, and I would have liked to see an acknowledgement that one local study does not make for global evidence, as the authors are careful to observe elsewhere. Additionally, the overall failure of microfinance-funded businesses to grow and move into the formal economy is not really addressed. For me, this represents the largest information gap in the book, but perhaps also reflects the lack of research on these topics to date.

The authors' years of research and classroom experience shines through in this book. It is well written and easy to read, clear, concise and entertaining – something few academic books manage without patronising the reader. And it provides the perfect mix of academic research, brief illustrative case studies and theoretical support for the arguments it puts forward. Intelligent

discussion of credible academic research allows readers to draw their own conclusions, and the authors have pointed out many of the gaps and deficiencies in the literature.

This book, now available as paperback, is essential reading for those interested in going beyond the practical aspects of how to run a microfinance program and into some of the bigger questions of incentives, effectiveness and sustainability. I hope this book will inspire new thinking about microfinance, and some innovative, evidence-based ways to do good things better.

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