

The Miracle of Microfinance? Evidence from a Randomized Evaluation

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Microcredit has spread rapidly since its beginnings in the late 1970s, but whether and how much it helps the poor is the subject of intense debate. Despite high hopes for microcredit's potential to transform the lives of the poor, there is a lack of concrete evidence demonstrating its impact. Skeptics fear that microfinance is displacing more effective anti-poverty measures or even contributing to long-term poverty via over indebtedness. This paper reports on the first randomized evaluation of the impact of introducing microcredit in a new market. Based on a survey of slums in Hyderabad, India, the authors find mixed results on a range of impact measures.

Surveying the Slums

Self-selection into microfinance programs, and the tendency of MFIs to enter more profitable areas first, makes carrying out rigorous impact studies between clients and non-clients challenging. The ideal way to estimate impact is to compare areas randomly assigned to receive access to microcredit to areas randomly assigned not to. In this case, half of 104 slums in Hyderabad were randomly selected for the opening of an MFI branch while the remainder were not. Access to credit resulted in a level of microlending 44 percent higher than in control areas, enabling the researchers to measure the impact of microcredit in those neighborhoods. 15 to 18 months after the opening of the MFI branch, a comprehensive survey was conducted of 6,850 households. Researchers examined changes in outcomes that directly relate to poverty, such as consumption, new business creation, and business income, as well as measures of other human development outcomes such as education, health and women's empowerment.

Results

The findings suggest that access to microcredit has important effects on household expenditure patterns and the creation and expansion of businesses. There is no effect, however, on health, education, women's decision-making, or average monthly expenditure overall, at least in the short-term. The effects on spending patterns in the treatment group were varied. Households with pre-

existing businesses invested in durable goods, and profits from these pre-existing businesses were higher than those in the control group. Households with high propensity to become business owners saw an increase in durable expenses and a decrease in nondurable expenses, including a 17% drop in the consumption of "temptation goods" such as alcohol, tobacco, and gambling. This change is presumably due to the costs of financing a start-up investment, as 32% more new businesses were created in the treatment group than in the control group. Households with low propensity to become business owners saw nondurable spending increase, consistent with using microcredit to pay down more expensive debt or borrow against future income. The authors found no impact on measures of health, education, or women's decision-making, suggesting that access to microloans does not generate short-term effects on household welfare.

Policy Implications

The authors caution that the results say little about the long-term effects of microcredit. It is possible that impacts on education, health, or women's empowerment could emerge after a longer time, when the investment impacts may have translated into higher total expenditure for more households. However, at least in the short-term, microcredit does not appear to be a recipe for changing education, health, or women's decision-making. Microcredit therefore may not be the "miracle" that some have claimed, but it does allow households to borrow, invest, and create and expand businesses.