What have we learnt?
The Evidence on Microfinance

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[1] Disclaimer: The views expressed are the author's and do not necessarily reflect official positions of the Federal Reserve System.

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- Draw ideas from existing "informal sector" credit mechanisms
- Aims to create a viable conduit for capital infusions from donors, government and formal sector banks.

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- Three–fourth of this amount is raised from domestic markets
- Almost \$6 billion in deposits where MFIs are allowed to take deposits. Most of 10,000 MFIs are not deposit taking and unlikely to be so given regulations governing deposit taking.

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- Domestic sources unlikely to generate contributions given rapid growth of MFIs
- Need to tap international capital markets as a steady source. . . where funding of the magnitude required is routine.

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Model I: Very Poor clients

Archetype of Grameen and Banco Sol

Four Principal Features

1. Joint liability (Ghatak, 2000; Armedariz de Aghion and Gollier, 2000)

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2. Close social networks (Karlan, 2007; Rai and Sjostrom, 2004)

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- Beyond Group Lending (Armedariz de Aghion and Morduch, 2000)

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- High repayment rates . . . .why does this model succeed?

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Reduces agency costs that relate to information asymmetry (Armedariz de Aghion and Gollier, 2000)

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- Peer group monitoring and "social sanction" reduces moral hazard and likelihood of strategic default (Stiglitz, 1990)

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Are strong social ties essential to success of joint liability?

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- Karlan (2007) provides direct evidence that relationships deteriorate after default, and that through successful monitoring, individuals know who to punish and who not to punish after default.

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- Second generation puzzle: goes against the economic argument behind credit rationing
- Do MFIs face an inelastic demand for loans? (Deheija, Montgomery and Morduch, 2005)

3. Missing labor markets

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- Suggests that poor labor market conditions are important to the success of microfinance

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- Strong evidence in terms of family health, nutrition and education (Khandekar, 2003)

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Accepted husbands into women-only Grameen style groups has improved transparency within the family, reduced conflict, and empowered women (Karlan and Mullianathan)

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- Break away from traditional microfinance: requirement of collateral
- Wealthier and most-established borrowers post collateral with low salvage value but high project specificity

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- the use of "non-refinancing threats."

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  [Morduch (1999) using the widely used "squared poverty gap" (Foster, Greer, and Thorbecke, 1984) measure of poverty]

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"We are not paternalistic, we do not lend to the poor"
Monica Hernandez, Banco Solidario, Ecuador.
Economist, Nov 3,2005

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- In keeping with their overall goal of poverty alleviation (Yunus, 2002)

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Which is better?

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- MFI competition needed to lower rates but credit registries needed to ensure compliance and repayment.

  Banco Sol and other regulated financial intermediaries are now required to report the name and national identification number of delinquent borrowers to the Superintendent of Banks and Financial Institutions.

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4. Need to harness a working model so that commerical funding for microfinance does not dry up as it has for subprime.