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*Anniversary  
Special*

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on Industrial Policy

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## Developing Strategies for NATION BUILDING

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## Facts & Figures

- ❖ According to a study carried out in 2006, the GDP of the 41 heavily indebted poor countries with 567 million people was less than the total wealth of the world's 7 richest people.
- ❖ In the same year, world gross domestic product was US\$48.2 trillion out of which the contribution of the world's wealthiest nations was US\$36.6 trillion.
- ❖ In 2004, the world's 8.3 million rich people, about 0.13% of the world's population, controlled nearly 25% of the world's financial assets.
- ❖ In 1998, all developing countries spent US\$13 billion on health and nutrition while Europe alone spent US\$105 billion on alcoholic drinks.
- ❖ In 2006, an estimated 1.1 billion people in developing countries had inadequate access to water while 2.6 billion lacked basic sanitation.
- ❖ A study in 2004 found that for every dollar in aid a developing country receives more than 25 dollars is spent on debt repayment. And the poorer the country the more likely it is that the money for debt repayments is taken directly from the people who have neither contracted the loans nor received any of the money.
- ❖ China accounts for the highest reduction in world poverty so far, nearly 700 million Chinese coming out of the clutches of poverty since 1981.
- ❖ The traditional poverty line of US\$1 a day is highly contested as it downplays the number of people suffering the true intensity of poverty even in the poorest countries in the world. Many would put the figure at minimum US\$1.45 a day while US\$2.50 for developing countries. In the US, \$10 a day is close to poverty levels.



## Abhijit Banerjee on Microcredit



**Abhijit Vinayak Banerjee (AB)** is Ford Foundation International Professor of Economics at MIT. A fellow of the American Academy of Arts and Sciences and Econometric Society, Abhijit focuses on development, information theory and macro-economics. He has numerous scholarly publications and his recent books include, "Making Aid Work," and "Understanding Poverty."

**ET:** Evidence from a randomized experiment carried out by your team in India suggests that while in some cases microcredit had some positive impact on micro-enterprises, it had insignificant impact on the wellbeing of its recipients (on women's empowerment or health). What are the implications of these findings?

**AB:** I would not take the negative results as definitive. I don't think anybody has any idea of how long it takes to achieve women's empowerment or improve health [through microcredit]. We are collecting data for the second round and we will look into this again.

Empowering women or improving their health in a social context — changing

the way we do things — is likely to be difficult in the short run. It is not implausible that a fair amount of overall social change that has to happen before substantial improvement in women's health or social status can be achieved.

It could very well happen. I have been surprised before and I will be keen to be surprised again.

The goal of our study was to explore what solid evidence we could gather on microcredit and to think harder about the general causal channels through which microcredit can be beneficial and the extent to which they are beneficial.

People may have expected a miracle through micro-credit, but what our data shows is that generating a miracle [through micro-credit] is harder than imagined. It provides a useful warning; right now, the evidence suggests not that such a miracle could not be achieved but that we should not bank on it.

**ET:** Microcredit interventions come in many flavors. Many NGOs provide business ideas, management trainings and so on. Perhaps these features, in addition to the vanilla micro-credit product, might provide better results.



**AB:** Perhaps, yes. Let me here focus on business training. Right now the evidence [See the recent works by Rohini Pande and Erica Field, and Dean Karlan et al.] is patchy. It is not quite clear what exactly it is that microenterprises find difficult about moving into a different business model [to transform themselves into larger business establishments]. What makes it [a micro-entrepreneurial venture] a success? How much is it marketing imagination, how much is it meeting the right person who then helps you? I don't think we have a great idea there. What we know is that providing some training on accounting for a week is not likely to do very much.

There is also a presumption that micro-entrepreneurs are trying to expand their businesses. But, many are content to leave their businesses the way they are; it [micro-entrepreneurial activity] is only a small part of their life and they are involved in other activities also. [Therefore, they may not even put enough effort to scale up their micro-enterprises.]

However, I don't think there is any reason to close the book on it [business training]. I think a lot of exciting work is going on and the evaluations are useful [to screen out ineffective training interventions]. My suspicion is a lot of these training programs will not work, and we will eventually come up with a few trainings that are useful and will generate some improvement. But will they turn many [microenterprises] into 50-employee firms within three years? – I don't think so.

**ET:** Do you think microenterprises are an efficient way of organizing production? Is it not the case that the scale of these enterprises and skills of their entrepreneurs are limited?

**AB:** I am mostly of the view that skills are important, that productivity is pretty low at small scale. The idea that somehow you can scale up incrementally to a point where

productivity is substantially high may be implausible. After all, these are tiny enterprises and savings generated from them will not be much. I think you are right that productivity is a huge issue and will be inherently low in these firms.

If you give poor women an opportunity to work at a larger factory where they would be able to make more money, surely they will grab it. That said there may not be anyone setting up that factory – and there are a host of reasons why that is not happening. The alternatives to micro-credit may not exist, and it is not the case that if you stop microcredit a lot of factories will emerge.

**ET:** From a national policy perspective should micro-credit be viewed as a



safety-net strategy or as an engine for economic growth?

**AB:** Even if you found that one in 10,000 microenterprise turns out to be a successful business that's worth it and that will generate growth. If we can quadruple that number, that's even better.

In some sense we do not know where new talents come from. It is not that the government is in a position to put a lot of resources right into the hands of those who are going to set up wonderful businesses. Countries that mostly tried this did not do well. Now there are some programs that are aiding small and medium businesses to grow. And in terms of growth they might be

more impactful than micro-credit.

Micro-credit, however, has its advantage. In principle it provides an opportunity for the poor to become entrepreneurs. And I think that there is value added to changing the dynamics of who becomes an entrepreneur irrespective of whether that actually quantitatively promotes growth less than other policies. Given that we know so little about policies on growth in general, policies that give people more opportunities – I would call that pro-growth with the caveat that I am not very fond of this distinction between pro-growth and pro-social safety net.

**ET:** Any other recommendations for policymakers and practitioners?

**AB:** I don't see strong evidence to suggest that we should make a strong distinction between loans for production and for other purposes. The median borrower in our data had already borrowed money from local moneylenders and the loans [from that source] were greater than those she received through a microcredit organization. She is borrowing money for a variety of reasons. Loans from moneylenders have extremely high interest rates, and the borrower is repaying those loans. In that world I don't see why introducing a lower

interest rate loan is not welfare improving. If someone borrowed Taka 10,000 less from moneylenders and borrowed that amount from a microcredit organization, that would be great.

I think savings is a big concern for the poor. The government should promote efficient ways of channeling savings from the poor to the banking system so that they have some option to save. Microcredit organizations may be important intermediaries. Now, this is a dangerous business, because you don't want someone to run away with money, but organizations like Grameen and Brac certainly have enough reputation to act as savings collectors. □