

Reforming microfinance

SIR – Your leader on micro-finance institutions (MFIs) provided the right prescription for the wrong reasons and compounded the misdiagnosis with the wrong headline, “Leave well alone”, (November 20th). You prescribed “sensible regulation”, but apparently because “MFIs typically have wafer-thin margins” and pressing them to reduce interest rates would hurt their ability to attract private capital and inhibit growth. You argued that slow growth, in turn, would “hampers their ability to harness economies of scale in order to lower transaction costs and cut rates of their own accord.”

Actually, the problem with microfinance in India is the opposite of what you suggest; the largest MFIs have grown fast, overachieved on economies of scale and have very high average margins. Growth itself has become a big problem because it ignores two factors that made micro-finance an important tool in fighting poverty: building relationships that were constructive and supportive of clients and outreach programmes to neglected areas.

It is precisely for those reasons that a “sensible regulation” that allows MFIs to take deposits and set rules on capital buffers would be so appropriate. Taking deposits would help round out the present unidimensional relationship of MFIs with their low-income clients. Appropriate rules on capital buffers would reduce the dependence on socially imprudent private investors, who have encouraged growth without regard for the impact on clients. More involvement by the Reserve Bank of India would, in any case, stabilise the industry and reduce the temptation for politicians to stir up populism. So no, do not “leave well alone”; those at the bottom of the pyramid should get the attention they deserve.

SANJAY SENHA
Managing director
Micro-Credit Ratings
International
Gurgaon, India

Overhauling pensions

SIR – You sensibly advocated cutting costs to Social Security in your briefing on ways to reduce America's deficit (“Confronting the monster”, November 20th). Why not abolish the programme? There is very little liberal justification for Social Security, given that the private-sector market for planning and saving for retirements is already highly competitive. Furthermore, because of the upper limit on payroll taxes, Social Security is regressive and redistributes wealth to the rich.

CARL SCHWAB
Arlington, Virginia

SIR – What difference will raising the retirement age make? With unemployment at 9.6% and additional legions of underemployed and those who have ceased looking for work altogether, do you really believe it is better to keep somebody in their 60s in a job? For three more years, and to produce what?

In the affluent town where I live there are college graduates working on the supermarket checkout and elderly folk (not so recently out of college) bagging the groceries. The jobs once occupied by high-school kids trying to make some pocket change have been usurped by the overqualified and the aged. Instead of increasing the retirement age we should prolong high-school a few years.

MARIO ZAPATA
Wilton, Connecticut

SIR – It is extraordinary to me, how, after the failure of fiscal austerity to “reassure” bond markets over the reliability of Greek, Irish and Portuguese debt, *The Economist* does not draw the obvious conclusion that such measures do not work. Simply because measures are harsh or painful does not mean they will be effective. Policy that leads to economic contraction hurts government revenues and makes budget gaps harder to close in the long term.

AARON BAKER
Portland, Oregon

Hayek and von Mises

SIR – Buttonwood asked, “Why is the Austrian explanation of the crisis so little discussed?” (“Taking von Mises to pieces”, November 20th). The short answer is that the “Austrian school” of economic ideas has not been taught for a long time in any university department; hence the response of the economic establishment that the current crisis could not have been foreseen. Outside this establishment there are some exceptions and one whom Buttonwood did not mention is the estimable Bernard Connolly, who has described the unfolding crisis for over a decade with more accuracy than any other economist on the planet.

DEREK SCOTT
Economic adviser to the British
prime minister, 1997–2003
London

SIR – The reason why the Austrian explanation is so little discussed is because the Austrian response to the crisis is simply to wait it out. There is nothing to discuss. The Austrian school agrees with Jean-Baptiste Say, a French economist in the early 19th century, that all recessions are the result of an overexpansion of credit. The implication is that a contraction will follow.

Then in the mid-19th century, in “Lombard Street”, Walter Bagehot wrote that if that contraction turns into a crisis, forget about economic theory, just bail out the banks. There is nothing to discuss.

DAVID PARKER
San Francisco

SIR – Buttonwood might find the answer to his question in the quote he cited from Friedrich Hayek: “The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.”

I can't imagine economists admitting how little they actually know. If they admit it to themselves it will hurt their ego; if they admit it to others it will hurt their job prospects.

JOSEF MATTES
Vienna

Tea-party flavours

SIR – Your characterisation of the Republicans as more or less “tannin-stained”, based on the extensiveness of their connections to the tea party, was intriguing (“Rocking the party”, November 13th.) On that premise, Senator Mitch McConnell must be Lipton, the historic, readily available brand in America that is neither interesting nor strong but will do the trick when nothing else is at hand. Senator Jim DeMint is clearly herbal, at first blush appealing, particularly when you have a nasty hangover, later regretted when it sours your stomach. John Boehner, the next Speaker of the House? Why, Orange Pekoe of course. Need an explanation really be given?

What remains to be seen is whether the rest are English Breakfast or Earl Grey. In other words, can they wake up to a mug of Cameron/Clegg-style fiscal austerity or are they just a bunch of posers covering up lousy policies with flowery rhetoric?

GEORGE CLARKE
Washington, DC

Ground control to major fraud

SIR – How right you were to think that spammers are becoming ever more creative (“Confidence game”, November 20th). Only last week I received an e-mail from the “Nigerian Space Agency” asking me for assistance in connection with the rescue of a Nigerian astronaut stranded on the Soviet Salyut 6 space station, where he has apparently been stuck since a secret space flight took him there in 1989, never to return after the subsequent demise of the Soviet Union. Ian Fleming would have been impressed.

JULIUS HUGELSHOFER
Paris ■

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Microfinance

Leave well alone

Capping microfinance interest rates will hurt the poor. There are better ways to regulate the industry

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MICROFINANCE is an example of something that is sadly all too rare: an anti-poverty tool that usually at least breaks even. If you make small, uncollateralised business loans to groups of poor women, they almost always repay them on time. It has grown rapidly in many countries, not least Bangladesh and India. With nearly 30m clients each, these are now the world's biggest markets for microfinance. Yet the industry has come under attack for being too commercial.

In Bangladesh the government has capped the annual interest rate that microfinance institutions (MFIs) can charge at 27%. In India a new breed of for-profit microlenders has shaken up an otherwise NGO-dominated sector—and annoyed the authorities. In Andhra Pradesh (AP), the Indian state with the most microfinance borrowers and the base for the biggest for-profit MFIs, local politicians have bullied the business to a virtual halt. An interest-rate cap is mooted. These steps are ostensibly motivated by a desire to defend the poor from getting stuck in a debt. But they are wrong-headed.

Despite charging what may seem high interest rates, MFIs typically have wafer-thin margins because of the high costs of making and collecting payments on millions of tiny loans. Pressing them to reduce rates further would jeopardise their ability to attract private capital, inhibiting their growth. Slower growth would in turn hamper their ability to harness economies of scale in order to lower transaction costs and cut rates of their own accord, as many—including the biggest for-profit MFIs—have done in the past. Forcing down rates would also deter new entrants and reduce competition.

The rush to impose restrictions on MFIs also betrays a fundamental misunderstanding about how the poor use credit. Many politicians cite the existence of clients with loans from several MFIs at once to argue that the poor are over-indebted. This ignores the fact that most microcredit loans are tiny, so that several are needed to meet the needs of even a small business. Indeed, the poor often use microloans to pay off far more expensive loans from village moneylenders. This suggests that restricting people's access to microcredit by capping rates could have the perverse effect of driving more poor people into the arms of village loan-sharks, who still provide the bulk of rural credit in poor countries. (In rural AP, 82% of households have such informal loans, whereas only 11% have loans from MFIs.) That would be good news for these moneylenders, but is surely not the outcome that policymakers want.

Peruse prudent

Sensible regulation need not be at odds with a thriving microfinance industry. Peru, for example, is ranked by the Economist Intelligence Unit (our sister company) as having the best business environment for microfinance, in part because the regulator has successfully set and enforced rules on capital buffers, leading to a more stable environment for the industry. India, in contrast, is yet to decide whether rules governing microfinance are to be set at the national level or by individual states.

An association of Indian MFIs is trying to set up a credit bureau which would allow them to track clients' overall indebtedness and credit histories, thus guarding them against lending a person more than she is able to handle. This would be helped enormously if the government speeded up its efforts to give all Indians a universal identification number. The Indian government should also allow MFIs to take deposits, which they are currently prevented from doing: this would make them less dependent on capital markets for funding. All rather complicated things, unlikely to stir up populism. And all a lot more useful for the poor than an interest-rate cap.

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