The last few months have been busy at the IFS’s Centre for Evaluation of Development Policy (EDePo). In November, we held a briefing on child development and policy, as part of the ESRC Festival of Social Science, bringing together academics, donors and policymakers from the UK and overseas. In December we hosted a Microfinance Club UK event at which we presented results from a microfinance project in rural Mongolia. And, EDePo senior researcher Laura Abramovsky was awarded an SIID-ESRC fellowship to take part in a global consultation on the post 2015 development goals.

Recent publications include an evaluation of an early childhood development programme in Colombia, published in the British Medical Journal. And in two new IFS working papers, Abramovsky et al demonstrate the challenges of achieving impact with social protection programmes at scale and Advani and Malde offer an in-depth review of the literature studying econometric methods for the analysis of social networks.

There has also been a lot of activity in the field. We have completed follow up data-collection for an evaluation of subsidised day care in Colombia, and baseline data is being collected in Nigeria for evaluation of community-led sanitation programmes being implemented by WaterAid. EDePo researchers have also begun participating in the World Bank’s ieGovern initiative, aimed at improving the evaluation of governance and public sector reforms.

In this issue of the Digest, our focus topic is microfinance, and Britta Augsburg explains our research in Mongolia and Bosnia, and how this has impacted subsequent policy. Laura Abramovsky, Orazio Attanasio and David Phillips also summarise work on the efficiency and distributional impact of indirect taxes in Mexico, emphasising the role tax evasion and informality play in developing country contexts. As usual we have information on upcoming events – including more on our first conference.

Don’t forget you can also check out our website for information on all our work.
Microfinance: effectiveness, delivery and mechanisms

For a long time, microfinance - the extension of very small loans to poor people - was cheered as an excellent policy to spur entrepreneurship and alleviate poverty. But over the last few years, controversies in India and Bangladesh have led to a much more cautious view of such schemes. Since 2008, EDePo researchers have been tackling the question of how effective microfinance is as a poverty reduction tool, and how its effects differ according to the design of the schemes. In doing this we have undertaken randomized impact evaluations in a range of countries.

The research addresses topics hotly debated in the microfinance industry. Two recently completed studies in Mongolia and Bosnia and Herzegovina, both undertaken in collaboration with the European Bank for Reconstruction and Development (EBRD), focus on whether microfinance can be extended to poorer, previously excluded parts of the population, and on the effectiveness of group lending – where liability for repayment is shared among a group of borrowers – compared to individual lending. Results of both studies suggest that access to microcredit – be it group or individual loans - has modest and somewhat mixed impacts on borrowers and their households; it does not appear to be the transformational tool sometimes claimed. Our evidence also suggests that the current move of the industry away from group and towards individual lending might lead to the exclusion of more vulnerable and poorer parts of the population.

We find that Mongolian women who receive access to a group liability product are more likely to make investments for productive purposes (such as setting up a business) – a strategy which leads these types of borrowers to experience an increase in their consumption (particularly food consumption). On the other hand, those offered an individual lending product do not increase entrepreneurial activity, and the availability of such loans has no impact on consumption or other measures of wellbeing.

We also find that group lending boosts loan take-up by poorer, less skilled individuals, and postulate that this is because such individuals particularly value intra-group cooperation and support, and the scope for risk diversification. Group loans also seem particularly popular in villages with higher levels of reported income risk, perhaps for similar reasons. Despite the fact that this might be expected to increase the risk to the lender of group loans, we do not find any differences in their repayment performance.

The impact on poverty of loosening lending criteria a little in Bosnia and Herzegovina to offer individual loans to poorer and less skilled clients (who are generally deemed at higher risk of repayment problems) was mixed. We find evidence of lower employment but higher self-employment, and increases in business inventory, as well as some evidence of increases in profits, among those operating businesses. At the same time, however, we find an increase in the labour supply of 16–19-year-olds in households’ businesses, a reduction in consumption and saving, and no evidence that the program increased overall household income.

These studies were selected to be part of a special issue on the effectiveness of microfinance published last month (January 2015) in one of the top economic journals, the AEJ: Applied Economics. The findings are in line with the other four studies published in the special issue, showing modest and somewhat mixed results for microfinance as an anti-poverty tool.

Current ongoing work at IFS looks at the effectiveness of using microfinance in more focussed interventions, namely as a financial tool to eradicate open defecation. Sanitation, acknowledged as the “orphan development goal” is receiving considerable attention from governments and funders and IFS is engaged in a number of projects, looking to contribute to knowledge on effective policies and programs in tackling this issue.
From the Field

How do our partners respond to our findings?

The results of academic studies and impact evaluation (and collections of these, such as the special issue on microfinance in the American Economic Journal: Applied), provide a lot of information relevant for the choice and design of policies and programmes. Years of analysis and costly data collection goes into such studies. But how useful are the findings to the implementers of studied programs under consideration?

We went back to our implementing partners of the microfinance evaluation studies in Bosnia and Mongolia to find out whether - and if so what - action they had taken based on our findings.

In Mongolia, our partner’s rational for joining the study had been to find means of reaching poorer rural women. While our findings suggested that group loans are more beneficial to poorer women with fewer skills, our implementing partner decided not to adopt this loan product. They preferred to continue with individual lending, satisfied by findings that this product was valued and adopted by many poor rural women, and indicated concern about risks to their loan portfolio quality from group lending (although we found no evidence of higher defaults for group loans).

Our Bosnian partner had long discussions with their board and funders in response to study findings, particularly given evidence that teenagers in households of marginal clients increased their labour supply and reduced their attendance or enrolment in school. Based on these, they decided not to adopt the relaxed selection criteria that allowed marginal clients to receive loans during the period of the study. However, they did adjust their selection criteria slightly, allowing, for example, owners of non-registered businesses to take loans with them.

Methodology Matters

Explaining probabilities

The last issue of our newsletter introduced EDePo’s work on eliciting expectations from study participants. We explained there how we used such methods to measure mothers’ perception of the usefulness of play and stimulation for children’s development. We have also used these methods to elicit information about people’s income expectations, and the uncertainty around these.

As part of the Mongolian microfinance project already mentioned, we wanted information on participants’ subjective probability distributions of future income, particularly of the projects they might undertake with a microfinance loan. The aim of this was to examine what role any differences in the (perceived) riskiness of the projects available in different villages (as well as underlying differences in income risk) played in differential loan take-up, and particularly how this varied according to whether individuals were offered individual or joint-liability loan schemes. This would provide evidence on which types of scheme could best support people facing different levels of underlying income and project-specific risk.

Crucial in the elicitation of this type of data is for respondents to understand the idea of probabilities and express their beliefs in percentages. IFS researchers have tested many different ways of explaining the idea of probabilities and for respondents to provide their answers. In Mongolia, the former – explaining the ideas of probabilities – was done using a unique Mongolian game (shagai), often played by herder families. The importance of utilising culture-specific examples should not be underestimated. Answers were then elicited through the means of rulers, after eliminating other means (such as using counting stones) following several days of piloting. When trying to obtain complex information from survey respondents, it is important to undertake trials to iron out any problems.

The data collected through these means allowed us to gain an understanding of the importance of risk in investment decisions of poor populations. Our findings show that poor and unskilled women especially value group-lending schemes as a means to mutually insure against potential adverse business outcomes.

This project was funded by the European Bank of Reconstruction and Development.
Weak direct tax systems mean that many developing countries have a particular reliance on indirect taxes, such as VAT and excise duties. Understanding the efficiency and distributional impact of such taxes, and the role of indirect versus direct tax/transfers in redistribution is therefore an important research question. A working paper by EDePo researchers explores these issues in the context of debates about how to reform indirect taxes in Mexico.

In 2010, as part of a package of revenue-raising measures, the Mexican government proposed a new 2% expenditure tax to be levied on all goods and services – including those to which a zero rate of normal VAT applied, such as many foodstuffs. Following opposition, however, the legislature amended the policy to a smaller increase in the normal rate of VAT from 15% to 16% with food (and a number of other goods) remaining subject to a 0% rate. This change reflected a broader and ongoing debate about the correct structure of indirect taxation in developing (and, indeed, developed) countries. Many economists advocate application of a single uniform rate of VAT in order to avoid distortions to consumption and to avoid the administration and enforcement issues that arise with VAT rate differentiation (see Mirrlees et al (2011), and Levy (2008). Other economists (such Bird and Zolt (2005)) advocate the use of zero- or reduced- rates for necessities like basic foodstuffs as part of efforts to ensure tax/benefit system progressivity in the context of weak capacity for administering direct taxes and transfers.

Using a new tax microsimulation model (MEXTAX), we show that the approved increase in the standard rate of VAT was indeed more progressive than the proposed uniform 2% expenditure tax. Measured as a percentage of expenditure, the gains from the amendments were largest for poorer households (see Figure). But, in cash terms, the biggest gains were for the highest spending households. Redistribution via reduced rates of VAT is therefore not particularly well targeted – a flat rate cash transfer costing the same amount as the amendments to the initial proposals would have benefited households in the poorest tenth of the expenditure distribution by more than 2.5 times as much as the amendments did, for instance. And many middle income countries do appear to be able to successfully operate more complicated targeted cash transfer programmes – like Mexico’s Oportunidades.

Redistribution therefore provides only a weak justification for deviation from a uniform rate of VAT. On the other hand, how strong is the efficiency case for uniformity? In order to assess this, a quadratic almost ideal demand system (QUAIDS) is estimated, and the behavioural and welfare implications of replacing the existing system of VAT with a revenue-neutral (and lower) uniform rate of VAT are calculated. As expected, such a reform would be regressive – with poorer households losing, and richer households gaining. In aggregate, the welfare gains to some households outweigh the losses to others, so in principle it should be possible to redistribute the gains and leave everybody either better off or no worse off. But only just: the gain in efficiency is equivalent to just 0.1% of overall expenditure. In other words, the efficiency case for uniformity turns out to be not that strong.

And simple models like the QUAIDS abstract from issues like tax evasion, and home production of goods and services. If people are able to more easily evade taxes levied on some goods and services than others - by buying from informal vendors or by making them at home say, there may be an efficiency case for levying lower taxes on such goods. Mexican household data show much higher levels of home-production and purchase from informal vendors for food than other goods and services, for instance. So while the case for excluding things like food from the VAT base in Mexico for reasons of equity appears fairly weak, perhaps there is in fact an efficiency reason to do so, or at least to impose a reduced rate. This turns the usual arguments on their head – and is the subject of ongoing EDePo research.
Event in Focus
EDePo Conference

Improving productivity in developing countries: identifying bottlenecks and obstacles to productive investments and technology adoption

08-09 July 2015
Goodenough College, London, UK

EDePo is hosting its first major conference this July. It will cover all areas of development economics, but with a particular focus on the following types of constraints to investment and technology adoption:

- Constraints on informational resources such as knowledge
- Market failures such as credit constraints or the unavailability of insurance
- Lack of market linkages or support facilities
- Constraints relating to social norms

The organisers are seeking submissions of high quality papers studying these and other constraints to economic development (submissions must be made by February 28th). To book your place, download the booking form and email to events@ifs.org.uk. The conference fee is £75 (inc.VAT) and includes refreshments, lunch, and the conference dinner. Further information can be found here.

Contact
EDePo @ IFS
Tel: 020 7291 4800
Email: info.edepo@ifs.org.uk

Centre for the Evaluation of Development Policy,
Institute for Fiscal Studies,
7 Ridgmount Street, London, WC1E 7AE, UK