Helpdesk Research Report: Impact of microcredit interest rates on the poor

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Query: Please synthesise evidence of the impact of microcredit interest rates on the poor. Is it desirable to place a cap on the interest rates charged by microfinance institutions (MFIs)?

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1. Overview

For some time, policymakers have been concerned about the effects of the seemingly high interest rates typically charged by microfinance institutions (MFI) lending money to poor people. Available data indicates that microfinance interest rates typically fall between 20 per cent and 50 per cent per year (in places where inflation runs no higher than 10 per cent per year)[1]. It has been argued that such interest rates can erode surpluses generated by borrowers, leaving them with little net gain. There is also concern that high rates reduce the demand for and uptake of financial services. As Dehejia, Montgomery and Morduch (2012) point out, where these effects are seen, high interest rates can undermine 'the original intention of the push for microfinance'.

But whilst experts agree that high interest rates intuitively make it more difficult for poor people to repay micro loans, in practice there is little evidence of these effects, and little research has been done in this area. In the same way that there is ongoing debate about the impact of microcredit on poor people's wellbeing in general, there is also lack of clarity about whether and in what ways high

[1] The organisation MicroFinance Transparency collects interest rate data for individual country markets and publishes this as a series of interactive tables and graphs. This data is freely available at: http://data.mftransparency.org/data/countries/

interest rates might be harmful to the poor. As Stewart et al (2010) point out, whilst some studies 'allude' to negative impacts of high interest rates, there is a general paucity of rigorous impact studies on this topic.

The literature concerned with the 'fairness' of interest rates has largely adopted a supply-side perspective. It focuses on factors affecting the pricing of loans, typically using large-scale comparative data to assess what is and is not an acceptable level of profit for MFIs and establish whether or not the poor are being exploited by rates charged. High interest rates in the sector are generally seen as related to the high operational (and transaction) costs involved in providing high numbers of what are often considered to be relatively small loans. Another commonly cited driver of interest rates is the need for MFIs to achieve financial sustainability. Some have suggested that high interest rates might only justifiably be criticised where they produce excessive profits for MFIs, or where they result from operating inefficiencies that could be avoided (Rosenberg, Gonzalez and Narain, 2009).

The limited available literature on the impact of interest rates from the borrower perspective tends to focus on two main issues: the effects of high interest rates on demand for microcredit (or credit elasticity), and the effects on over-indebtedness. In both instances, research mainly takes the form of country-specific case studies. Recent systematic reviews which have looked at the impact of microcredit on users reveal little about the role of interest rates, and this has not been a key research question for these studies (Duvendack et al, 2011; Stewart et al, 2010).

With respect to the impact of interest rates on demand and indebtedness, the evidence is inconclusive and the literature raises a number of qualifications to the notion of a straightforward relationship between high interest rates and negative effects on borrower wellbeing, including the following.

- It is difficult to isolate the role of high interest rates in over-indebtedness, and studies tend to point to a range of factors related to the circumstances of the borrower and unforeseen shocks, as well as the role of MFI policies and how loans are priced (including interest rates).
- Whilst one or two qualitative studies have illustrated that high interest on loans is disliked by borrowers and may exacerbate their financial burden, it is clear that interest rates are not the only element of pricing that affect user's capacity to make repayments on time.
- The capacity to keep up interest payments may be dependent on how the loan is used. High interest rates may be particularly harmful in instances where investments yield low financial returns. One study in south Asia suggested that the types of activities that poor people use microcredit for typically generate moderate returns which reduce their capacity to service high interest loans (Fernando, 2006). Likewise, where microcredit is used to increase consumption, as opposed to making productive business investments, it may be infeasible to expect that high interest loans can have a positive effect on the finances of poor households in the short term (Stewart et al, 2010).
- Where high interest rates ensure the profitability and sustainability of the sector, and therefore the capacity of lenders to reach out to poor and remote users, some have argued that the impact of high rates, therefore, needs to be judged against the relative harm of poor people not having access to microcredit at all (Roodman, 2011).

Whilst high interest rates are of widespread concern, the literature is largely not in favour of imposing obligatory caps as the appropriate policy response for reducing them. Experts contacted in the course of preparing this report raised questions or expressed concerns about the idea of placing a cap on interest rates. In particular, what level should the cap be set at? Would it affect who lenders choose to

lend to – opting for the more efficient loans (borrowers that are more reliable/accessible)? Would the cap have to be re-adjusted periodically to reflect changing rates of inflation?[2] Some evidence indicates that caps can result in market contraction and reduced transparency (as MFIs opt for 'hidden charges' to cover costs). Encouraging competition and transparency are widely considered better ways to ensure consumer protection.

This brief report is organised in three sections: the first summarises the main factors seen to affect interest rates in the microfinance sector from a supply perspective, the second presents available case study evidence of the impact of interest rates on borrowers, the third synthesises the debate about whether or not capping rates is an appropriate policy response and presents some evidence of the impact of caps where they have been implemented. The report also highlights some alternative approaches to regulating the sector that have been put forward by experts.

2. Assessing the fairness of interest rates from a supply perspective

Criteria for fair pricing

There is a growing body of literature addressing the question of the 'fairness' of pricing in the microfinance sector. In a report prepared for the 2012 Micro Credit Summit, Waterfield (2011, no p.n) argues 'the pricing of microloan products forms a critical component in achieving the delicate balance between being financially sustainable and socially responsible'. He calls for 'responsible commercialization' in the sector, which is related to three intertwined factors: the delivery costs of the microfinance institution, the product prices that institutions charge, and the prices that clients can afford. The paper argues there is a moral obligation for the microfinance industry to address the challenge of defining ethical and responsible practice, and within that the issue of fair and ethical pricing.

Rosenberg, Gonzalez and Narain (2009) reviewed the interest rates of over 1,400 MFIs from 98 countries using data held on the Microfinance Information Exchange (MIX). Their aims were to compare rates, identify trends over time and directly address the question of whether the poor are being exploited by high rates. Whilst the authors did not use a theoretical framework, and acknowledged that assessing whether or not rates are fair relies partly on 'intuitive judgement', they nevertheless do set out some criteria. In principle, they argue, MFI interest rates should be calculated based on the sum of operating costs (including cost of funds, loan loss expenses and administrative costs) plus profit. They argue, therefore, that it is fair to criticise an MFI's interest rates as unreasonable 'only if its profit or some controllable element of its costs is unreasonable' (p.1). In other words, high interest rates might justifiably be criticised where they produce excessive profits for MFIs, or where they result from operating inefficiencies that could be avoided.

Rosenberg, Gonzalez and Narain's (2009, p.3) study concluded that 'MFI interest rates generally seem quite reasonable and that there is no evidence of any widespread pattern of abuse'. Their data suggested that in 2006 (the most recent year available) the median interest income for sustainable MFIs in MIX was 26.4 per cent. Hence, very high interest rates in cases that have attracted media attention and condemnation were not representative of the industry as a whole[3]. They also found that:

[2] These questions were raised by Ajaz Ahmed Khan of Care International.
[3] The authors refer specifically to the case of the Mexican MFI Compartamos which was operating at 85 per cent interest rates and was heavily criticised when in 2007 it sold shares that created millionaire stakeholders.

- MFI interest rates have been declining by 2.3 percentage points a year since 2003, much faster than bank rates.
- MFI interest rates were typically lower than credit card rates, and the rates paid to informal lenders, but higher than rates paid to credit unions.
- The level of administrative expenses is strongly related to the age of the MFI, with most established MFIs better able to achieve economies of scale.
- MFIs produced considerably lower returns on equity for their owners, although the top 10 per cent of the worldwide microcredit portfolios produced returns on equity above 34 per cent in 2006. The authors note this upper end of profit is likely to be considered unacceptable by some.
- Competition may not lower interest rates. Interest rates appear to have dropped in the markets where microcredit has already become competitive.

Crucially, the authors find that 'profits are not a predominant driver of interest rates. For the median MFI, the extreme and unrealistic scenario of complete elimination of all profit would cause its interest rate to drop by only about one-sixth. Such an interest reduction would not be insignificant, but it would still leave microcredit rates at levels that might look abusive to politicians and the public, neither of whom usually understand the high costs that tiny lending inevitably entails' (ibid, p. 21).

As Roodman (2011) points out, 'overall, although microcredit interest rates are steep by rich-world standards, once the higher cost of lending to the poor, the value of covering those costs in order to grow, and immaturity of the industry are taken into account, most rates do not seem exploitative' (p.10). He also argues that 'judging whether lending is fair and freeing is best done not by looking at a snapshot of the interest rate at one moment, but by understanding the relative power of borrower and lender'. For example, an MFI charging 50 per cent in a monopoly market may arouse more concern than one charging the same rate in a competitive market. Roodman places emphasis on the power dynamics between borrower and lender as being an important consideration, and points to three other aspects of lender behaviour that also matter for the question of fairness: transparency, reliability, and flexibility.

In an opinion piece, Nobel prize winner Muhammed Yunus (founder of the Grameen Bank), recommended the maximum interest rate charged by MFIs should not exceed the cost of the fund — meaning the cost that is incurred by the bank to procure the money to lend — plus 15 per cent of the fund[4]. However, Gonzalez (2010) argues that although Yunus' methodology is appealing in its simplicity, he stresses that costs vary between loan size and with difficult-to-reach clients (for instance, the very poor or those who live in sparsely populated areas). Roodman has similarly stressed that it is very difficult to determine a 'fair' rate by looking at cross-national data, partly because of the different costs associated with providing loans in different regions of the world. He notes that Yunus's ceiling effectively categorises three quarters of today's microcreditors as 'moneylenders and loan sharks' (p. 22).

Drivers of high interest rates

Two main arguments are common in the literature on what drives high interest rates in MFIs. These are the costs of operating, and the drive for sustainability.

[4] Article in New York Times, 15th January, 2011: http://www.nytimes.com/2011/01/15/opinion/15yunus.html?_r=0

The costs of operating and the 'price curve': Rosenberg, Gonzalez and Narain (2009, p.1) argue that administrative costs are 'inevitably' higher for small and micro-loans than for larger ones, because of the higher transaction costs involved. To illustrate, they note: 'lending $100,000 in 1,000 loans of $100 each will obviously require a lot more in staff salaries than making a single loan of $100,000' (ibid, p. 1). The result of the higher costs of providing small-sum loans is that, paradoxically, low-income users of microcredit services are likely to pay higher interest rates than higher-income borrowers using banking services.

Waterfield (2011) explains what is referred to as the 'price curve' in microfinance: meaning that higher prices necessarily have to be charged on issuing smaller loans, because the operating cost ratio for loans increases (dramatically) as loan size decreases. Hence, MFIs with the lowest prices in datasets also tend to have the largest average loan balances. Those MFIs with the highest prices have the smallest loan balances. In this way, the author argues, not all microfinance organisations are the same and assessing the 'fairness' of interest rates by looking at averages across MFIs with different loan balances is misleading. To illustrate, cross-country comparisons of efficiency show that Bolivian MFIs are efficient, but this is because they give very large loans. Philippine MFIs vary widely in efficiency because they cover a broad span of loan sizes, and Bangladeshi MFIs have fairly consistent efficiency figures because they deliver very similar loan products (ibid). Waterfield (2011, p.35) argues that instead of asking what is a fair 'price', the industry should be asking what is a fair profit.

The drive for sustainability: Some experts have argued that high interest rates are necessary to ensure the sustainability and future coverage of microcredit services for the poor. As the organisation Kiva states on its website, 'self-sustainability is critical to creating long-term solutions to poverty, and charging interest to borrowers is necessary for microfinance institutions to achieve this'[5]. Profitable microlenders are seen as less likely to be reliant on donor subsidies, and therefore more sustainable and able to deliver long-term, reliable services to clients. Self-sustaining MFIs can arguably then expand to serve more poor households (The MIX)[6]. As Karlan and Zinman's (2008, p.1) widely-cited study notes, 'nearly all MFIs face pressure from policymakers, donors and investors to eliminate their reliance on subsidies'. Nevertheless, as Dehejia, Montgomery, and Morduch (2012) argue, sustainability can sometimes give way to a strongly-felt moral imperative to keep costs as low as possible for poor people. For instance, some major microlenders in south Asia have kept real interest rates below 40 per cent even though this has meant relying on subsidised resources to cover their costs (ibid).

3. Evidence of impact of interest rates on borrowers

Effects on wellbeing

A recent systematic review which looked at evidence of the impact of microfinance on poor people in sub-Saharan Africa (Stewart et al, 2010) concluded that high interest rates were one among a number of reasons why microcredit can sometimes fail to increase the wellbeing of poor people. The report stated that: 'some people are made poorer, and not richer, by microfinance, particularly micro-credit clients. This seems to be because: they consume more instead of investing in their futures; their businesses fail to produce enough profit to pay high interest rates; their investment in other longer-

[5] See the KIVA website; http://www.kiva.org/about/partners As of December of 2012, the average interest rate and fees charged by Kiva's Field Partners is about 35 per cent.
[6] Source: the MIX website http://www.themix.org/about-microfinance/FAQ#ixzz2HTRNgRUm

term aspects of their futures is not sufficient to give a return on their investment; and because the context in which microfinance clients live is by definition fragile' (p. 5).

Overall, the review did find some evidence that microcredit can help poor people cope with economic shocks, but acknowledged that the implications of failure (to repay) high interest loans are high. This is because in order to repay high interest loans, borrowers effectively rely on an increase in their income (ibid, p.49): 'if clients are unable to increase their incomes, they will not only default on their loans, falling into a debt trap, but also be unable to invest in their savings accounts'. Returns on investment depend on how loan money is spent, which may fall into two broad categories: i) investing in the future (business or productive assets, education), and ii) increasing consumption (health, nutrition or housing). Overall, the report argues that investments in long-term outcomes such as increased primary school enrolment do not increase micro-credit clients' ability to repay their loans in the short-term, and may even lead to increased poverty. This leads the authors to conclude 'it seems short-sighted to expect that small loans with interest rates of between 25 per cent and 37 per cent might make very poor people richer' (ibid, p. 49).

On the other hand, Roodman (2011) analyses high interest rate loans to the poor from the perspective of Sen's 'development as freedom', noting that 'when you have nothing to eat till the harvest, you may be willing to pay a lot for loan: yes, the interest will cost you tomorrow, but if you do not eat, there will be no tomorrow' (p. 10).

Impact on indebtedness

Some country-specific case study research has provided insights into over-indebtedness from the borrower perspective. One case study in Ghana, undertaken by the Centre for European Research in Micro Finance, showed that user 'indebtedness' (defined as users not being able to keep up with repayments) was the result of a combination of factors, related to both borrower circumstances and MFI products and policies (Schicks, 2011). In terms of borrower circumstances, the economic challenges of failed business investments, loan use that does not earn returns, adverse shocks that reduce the borrower's income, and a lack of assets, especially savings, to serve as a buffer against delinquency, were all important causes of over-indebtedness. With regard to MFI policies, although interest rates were a frequent source of complaints, borrowers also cited inflexible product features as a main reason for their indebtedness. In particular, the study observed that instalment schedules did not always match borrowers' cash flows, and that loan disbursements may arrive too late to enable productive investments (p. 16). In interviews, borrowers themselves attributed repayment problems to high interest rates, but this was set among a number of other factors, including:

- the investment went wrong, or I started paying off too late compared to the instalments
- an emergency made repayments difficult
- the interest was too high or instalments too frequent
- the amount disbursed was too low for the required investment or was disbursed too late.

The study concluded that in this specific case, borrowers may still be better off with access to finance than without: 'Some Ghanaians seem to perceive a loan as something so precious that they would take it without reflection, no matter what the cost. This is a strong message not to overreact to over-indebtedness: Customer protection should aim to reduce borrower sacrifices. But customer protection measures that overly reduce poor people's access to loans may not always be the right response. Instead, a redesign of loan products seems to be called for' (Schicks, 2011, p.12).

A recent study in Bangladesh found that although the accumulation of high interest on loans may exacerbate the financial burden of microcredit users, they are not the main contributing factor to users being unable to make repayments on time. Jahiruddin et al (2011) used survey data and in-depth interviews with women whose circumstances had worsened following their borrowing microcredit loans, and revealed four key sets of circumstances in which poverty was exacerbated among the most vulnerable female borrowers:

- long periods between start-up and revenue generation from the investment
- financial setbacks or losses incurred during the initial stages of business
- use of the loan money to meet unforeseen contingencies/emergencies; and
- use of loan money for day-to-day consumption or one-off, 'luxury' expenditure.

Impact on demand

Helms and Reille (2004) drew on available literature to ask whether and how poor people can afford high interest rates. They put forward a number of arguments that question the extent to which high interest rates necessarily hurt the poor, including the following.

- The poor generally consider ongoing access to credit more important than the actual cost of the credit.
- Studies show that clients benefit from microfinance loans, and that they can and do repay loans.
- The higher costs of microcredit have not necessarily excluded poor customers. Data from the MIX indicates leading MFIs have succeeded in reaching large numbers of poor clients.
- Alternatives to microcredit tend to be very expensive moneylenders, input suppliers, inflexible and risky local savings circles, or nothing at all. It is common for moneylenders to charge effective interest rates well in excess of 10 percent per month.

In a widely-cited study, Karlan and Zinman (2008, p. 1-2) argue there has been an assumption of 'price inelastic demand' (meaning the poor are largely insensitive to interest rates) amongst policymakers. This has provided a foundation for encouraging MFIs to run at sustainable (profitable) interest rates on the basis that it is unlikely to reducing poor people's demand for, or access to microcredit. To test this assumption, they used an experimental research design to measure the effects of rate fluctuations (of between 50-200 per cent) on uptake of loans by new and existing customers in the case of a South African lender. The study found demand curves were gently downward sloping throughout a wide range of rates below the lender's standard ones, but that demand sensitivity rose sharply at prices above the lender's standard rates. Lower rates produced more borrowing by poor females in the sample. Higher rates also reduced repayment. They also found that 'loan price is not the only contracting parameter that might affect demand, and hence MFI profits and targeting. Liquidity constrained individuals may respond to *maturity* as well, since longer maturities reduce monthly payments and thereby improve cash flows' (ibid, p. 2). In fact the study found that maturity 'may actually be more influential than price in determining demand for credit if individuals are more concerned with monthly cash flows than interest expenses' (ibid, p. 2). In reviewing this study, Roodman (2011) points out that the subjects of the study lived well above standard poverty lines of $1 and $2 a day, and their successes revolved around employment, not entrepreneurship.

In a more recent study, Dehejia, Montgomery and Morduch (2012) similarly challenge what they see as a widely-held view among experts in the field that interest rates should be set at profit-making

levels on the basis that poor customers are primarily concerned with seeking *access* to credit, but are not necessarily as concerned with getting 'cheap' credit. They argue this assumption is questionable because in fact there is very little evidence of how interest rates affect demand for credit in poor communities (Dehejia, Montgomery and Morduch 2012). In particular, there are unanswered questions about whether poorer customers are deterred from accessing credit because of higher rates, or whether they are able to pay them (ibid). In their case study of the microlender *Safe*Save, operating in the slums of Dhaka, they show that poor households are in fact sensitive to price changes. An unexpected price increase, from a real interest rate around 18 per cent per year to a real rate of around 30 per cent per year (in line with the prices charged by other major Bangladeshi microlenders), did affect demand and use of microcredit services. Elasticities of loan demand with respect to changes in the interest rate ranged from − 0.73 to − 1.04 during the twelve months after the price increase. Moreover, in response to interest rate increases, users altered the way they borrowed – taking advantage of *Safe*Save's flexible lending policy by taking small and more frequent loans and repaying them more quickly. The authors note that it is important to acknowledge that *Safe*Save did achieve financial stability as a result of the interest rate increase. They suggest that future studies might better explore the heterogeneous impact of interest rate increases on demand for loans.

Rosenberg, Gonzalez and Narain (2009) argue that although interest rates have been the centre of debate about microcredit pricing, and have received the most attention, they are not the only cost that the poor pay in obtaining loans. They stress it is important to keep in mind the other transaction costs for the borrower, including spending time away from their businesses, transportation expenses, and the negative impact of delays in receiving loan funds. These costs are less easily quantifiable but may factor into the decisions that borrowers make about where they choose to obtain loans. In this sense, interest rates are not the only factor that affect demand for and access to loans (ibid).

Impact on the poorest

A review by the Asian Development Bank (ADB) (Fernando, 2006) argues the high cost of loans means the majority of the poorest people have not been reached. High interest rates also prevent the use of loans for activities that produce low returns, for instance farming activities. This is because 'only those who can generate a sufficiently high surplus of funds can afford high interest rates on microcredit. More specifically, a borrower's realized rate of return on investment needs to be greater than the interest rate to service the loan' (p.7). The report explains that although some enterprises with very high margins do exist in the region (petty trading, small-scale restaurants, bakeries, and micro-livestock activities) most investment opportunities typically involve more moderate returns. Households using loans in these ways do not have the same capacity to service high-interest loans because they are not making high enough returns on their investment. Indeed, poorer households are more likely to invest in low-return activities, including health, education and basic needs. The report concludes that it is, therefore, important to lower microcredit interest rates to enable the poorest households to benefit.

4. Feasibility and desirability of capping interest rates

Risks associated with capping interest rates

Policymakers have expressed concern that interest rate caps can reduce poor people's access to financial services. Based on a survey undertaken by CGAP of caps in around 40 developing and transitional countries that have interest rate ceilings of some kind, Helms and Reille (2004, p. 5)

argued interest rate ceilings make it 'difficult or impossible' for formal and semi-formal microlenders to cover their costs, driving them out of the market (or keeping them from entering in the first place). Poor clients are either left with no access to financial services or must revert to informal credit markets (such as local moneylenders), which are even more expensive. Moreover, they argue that ceilings can lead to less transparency about the costs of credit, as lenders cope with interest rate caps by adding confusing fees to their services.

As Waterfield (2011) argues, the price curve in microfinance means there is inevitably a point where a loan is too small to be provided sustainably when priced below a cap. In this way: 'the inevitable result of an usury limit is that loans below some certain amount will either disappear or will need to be subsidized by the lenders (possibly subsidized by profits made from larger loans). In either case, the likely result is a reduction in the supply of the smallest loans offered by formal institutions and the poor return to their informal credit sources' (p. 16).

Evidence of effects of caps

Dehejia, Montgomery and Morduch (2012) cite the case of Brazil in the early 1970s, where interest rates on loans for working capital were fixed at 17 per cent per year while inflation rates ranged from 20 to 40 per cent per year. They note that 'even where interest rate caps allowed positive real interest rates, they were seldom high enough to permit banks to cover costs. As a result, lending to the poor was a heavily-subsidized activity, monopolized by state-run banks. Too often, the subsidized resources went to non-poor households and political elites. Financial services tended to be low-quality, and scale was constrained by the size of government budgets' (no p.n).

Helms and Reille (2004) stress interest rate ceilings can take several forms[7], and their effects depend on two factors:

- The level of the interest rate ceiling itself*:* Low ceilings that do not allow for cost recovery can lead to 'market contraction', including the retreat of MFIs from more remote and therefore more costly areas as well as the reluctance of large commercial banks to expand into these market segments. This happened in Nicaragua after an interest rate ceiling was introduced in 2001 (p. 17). Interest rate ceilings in Colombia reportedly prevented NGOs from transforming into licensed financial intermediaries (p. 19), and in Kenya, the threat of a new interest rate ceiling bill reportedly caused the Cooperative Bank of Kenya to put its plans for a major expansion into the microfinance market on hold (p. 20).

- The level of enforcement*:* This can vary according to local conditions, including the clarity of the law or regulation and the incentives and institutional capacity of the enforcement agency. Laws can be especially difficult to enforce where they are proposed by politicians and not by agencies or other groups with expertise in finance. In some cases, interest rate ceilings have led to less transparency around pricing, as affected MFIs have attempted to circumnavigate ceilings by imposing new charges and fees to cover costs. These fees can be difficult for consumers to understand and can affect their capacity to compare prices across loans. This happened in Nicaragua (p. 22).

Alternative approaches to consumer protection

[7] Including rate controls, usury rates and de facto ceilings – see Box 3, p. 7 in Helms and Reille.

Whilst experts have raised concerns about capping, they acknowledge that policymakers need to respond in some way to predatory lending and the abuse of consumers. As an alternative to capping, Waterfield (2011) advocates increased transparency: 'With increased knowledge and transparency, true price competition can lead to better decisions by all stakeholders. Arguably, markets that do not practice transparent pricing are imperfect markets and price competition is absent. With increased competition there is more incentive to seek out innovations and efficiencies. Microfinance can continue to achieve improved efficiencies, and with increased competition these efficiencies lead to lower prices on microloans' (p. 20).

Helms and Reille (2004) similarly argue government should expand the reach of the financial sector by fostering innovation, competition, and transparency through appropriate legal and regulatory frameworks and consumer protection policies. In particular, they argue that competition is the 'single most effective way' to reduce both microcredit costs and interest rates: 'Policies to promote competition among credit providers, combined with relevant consumer protection measures like truth-in-lending laws, can go a long way toward expanding the reach of sustainable microcredit while safeguarding consumer interests' (ibid, p. 1).

A review by the Asian Development Bank (Fernando, 2006) also argues that whilst lower interest rates would no doubt increase the affordability of microcredit for the poor, imposing ceilings on rates – which is often a politically palatable measure – will not address the root causes of high interest rates, and may even exacerbate the problem. This is because it can act as a disincentive to expand operations, and subsequently prompt a decline in the supply of credit to MFIs. In Viet Nam and the People's Republic of China, interest rate ceilings have led to disappointing growth of outreach, and the financial dependence of MFIs on subsidies. They argue that promoting more competitive markets and efficiency offer a better way forward (p. 8).

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6. Additional Information

Key websites:
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Microfinance Transparency http://www.mftransparency.org/
Microfinance Information Exchange http://www.themix.org/

Experts consulted:
Ann Duval, Independent consultant
Maren Duvendack, ODI
Ajaz Ahmed Khan, CARE International

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Chuck Waterfield, Microfinance Transparency

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