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• RESEARCH ARTICLE

## Microcredit in Theory and Practice: Using Randomized Credit Scoring for Impact Evaluation

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ABSTRACT

Microcredit institutions spend billions of dollars fighting poverty by making small loans primarily to female entrepreneurs. Proponents argue that microcredit mitigates market failures, spurs micro-enterprise growth, and boosts borrowers' well-being. We tested these hypotheses with the use of an innovative, replicable experimental design that randomly assigned individual liability microloans (of \$225 on average) to 1601 individuals in the Philippines through credit scoring. After 11 to 22 months, we found evidence consistent with unmet demand at the current price (a roughly 60% annualized interest rate): Net borrowing increased in the treatment group relative to controls. However, the number of business activities and employees in the treatment group decreased relative to controls, and subjective well-being declined slightly. We also found little evidence that treatment effects were more pronounced for women. However, we did find that microloans increase ability to cope with risk, strengthen community ties, and increase access to informal credit. Thus, microcredit here may work, but through channels different from those often hypothesized by its proponents.

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