

Access to Finance

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The Financial Access Initiative is a consortium of researchers at New York University, Harvard, Yale and Innovations for Poverty Action.

FULL PAPER:

Karlan, Dean and Jonathan Morduch. "Access to Finance."
Chapter 2 in Dani Rodrik and Mark Rosenzweig, eds., *Handbook of Development Economics*, Vol. 5 (forthcoming).

Expanding access to financial services holds promise as a means to reduce poverty and spur economic development. But, as a practical matter, commercial banks have faced challenges expanding access to poor and low-income households in developing economies, and nonprofit institutions have had limited reach. Dean Karlan and Jonathan Morduch review recent innovations that are improving the quantity and quality of financial access globally. New models are taking possibilities well beyond early ones centered on providing microcredit for small business investment. Karlan and Morduch focus on new credit mechanisms and devices that help households manage cash flows, save, and cope with risk. They consider contract designs, product innovations, regulatory policy, and ultimately economic and social impacts. Their discussion relates the innovations and empirical evidence to theoretical ideas, and they make links in particular to new work in behavioral economics and to randomized evaluation methods.

Expanding Financial Access: Why & How

The chapter addresses seven topics in turn: global financial access; financial intermediation and economic growth; returns to capital; credit market innovations; understanding saving; insurance and risk management; and governments, businesses and non-profit institutions.

Karlan and Morduch first review data on global financial access. At the time of writing, existing estimates suggested that the number of “unbanked” and “underbanked” adults worldwide was between two and three billion people. Economic theory predicts that expanding financial access can spur economic growth, as a mechanism per se and via reduced inequality. Karlan and Morduch review empirical research that confirms the associations, but caution that attributing causality remains a challenge. While theoretical predictions about the returns to capital for microenterprises vary, empirical work is beginning to uncover factors that play a role in determining whether they are high or low.

The chapter turns to financial products and services created for and used by low-income households. Innovations

like group lending, adjusted repayment schedules and dynamic incentives for loan repayment have contributed to the rapid spread of microcredit. The impacts of microcredit remain unclear, however, despite a recent crop of rigorous evaluations. There have also been strides in the development of micro saving and insurance products. Compared to households in developed countries, low-income households in developing countries face different constraints on their ability to save. They can and do save, however. Informal mechanisms like saving clubs are prevalent. These tools create structure and allow users to make a binding commitment to save. Along with insights from behavioral economics, they provide guidance for creating formal and semi-formal saving products. Micro-insurance seeks to help vulnerable households better manage risks and cope with shocks. Innovations like partnership models and index-based insurance have gone a long way toward overcoming basic challenges, but demand remains low, suggesting that product designs can be improved. Recent years have seen a marked rise in commercial microfinance, but most institutions still rely on subsidies. These changes are creating a new set of issues for regulators to contend with,