TRANSCRIPT OF DEVELOPMENT DRUMS [EPISODE 31 – DAVID ROODMAN ON MICROFINANCE]

Host: Owen Barder. Guests: David Roodman

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Owen Barder
Thanks for downloading Episode 31 of Development Drums. My name is Owen Barder from the Center for Global Development. Today, we are talking about microfinance, and my guest today is David Roodman, a colleague here at CGD and the author of a new and important book, Due Diligence, An Impertinent Inquiry into Microfinance. David was a guest before on Development Drums back in 2008, when we were talking about the financial crisis and its effects on developing countries.

David, welcome to Development Drums.

David Roodman
Great to be here.

Owen Barder
So we are going to talk today about what the evidence tells us about the effect of microfinance on the lives of poor people and on the implications of that for aid donors and people who want to give money for poor countries. But I'd also like to explore with you later on in the show what you have learned about the roles of different kinds of evidence and also to hear something about how you wrote this book, because it was an interesting experience you did as an open blog. So instead of sitting in a darkened room on your own, you put it all online. So we will talk about that later. But let's begin with what I think for many people will be the key finding of your book, and I know it's probably quite frustrating for you that we try and reduce a rather rich complex story into this one key factoid. But let's get this out and see what to make of it. You say in your book that the purpose of research is responsible generalizations and is it a responsible generalization to say as I think your book says that on average microfinance does not lift people out of poverty?

David Roodman
Yeah, it's a good question. I think whether it's a responsible generalization, it depends on what you want to do with it. If you are in pursuit of absolute truth, then that would not be a responsible generalization because we have always studied the impact of micro-credit and micro savings at a few places at a few times. We don't know what the exact impacts are elsewhere. But if you are somebody who has to decide tomorrow whether to put $100 million into a micro-credit program, then you have to go with the data that you have. And right now, what the studies are showing, the best studies, the ones that are randomized and I think the most rigorous and reliable, is that micro-credit, which is one kind of microfinance is not systematically reducing the poverty of its clients.

Owen Barder
Not systematically doing so, so not doing so on average…

David Roodman
On average.

Owen Barder

So how do we reconcile this, we hear many good stories from individual microfinance organizations who tell us about individuals and communities who they say have been helped by micro-credit programs. And you are saying that the statistical evidence is that on average it isn't helping. How do we reconcile these two ways of seeing the world?

David Roodman
Well, you know, if you were to give loans to three friends, one might buy a television with it, another might open a restaurant and the restaurant would fail and another one might open the restaurant and have it succeed. You expect a given service to have a diversity of impacts both because the people who receive it are different and live in different context and because of luck.

Owen Barder
But to understand the average effect, right, in the case that you – an example you gave of three friends, if two of them have been helped or one of them has been helped a lot and one of them, it's a wash, then the other one has to be harmed for the average effect to be zero, right? I mean, are you saying that for everybody who we can point to who has been helped, there is someone who has been harmed to the same extent, so that it nets out.

David Roodman
Yeah, roughly speaking, that has to be the case within the limits of – there is statistical noise and so – but, yeah, overall, that's what it has to be and it's not that surprising once we put aside all the hype that we have heard about micro-credit. You know, loans are very useful, they have been very useful in my life in getting education, buying a house, but they are also dangerous and they cost money too, right? So they have to help people more than they cost in order for there to be a net benefit.

Owen Barder
There is a kind of assumption, isn't there that if you give a poor person a loan that they will become an entrepreneur? And of course many people don't have what it takes to be an entrepreneur. They, you know – I don't have what it takes to be an entrepreneur in many ways. Why would the average citizen be able to take – make use of a loan and make something out of it? Is your sense that we are pushing credit to people who – for whom that really isn't the thing that is preventing them from making this kind of a living?

David Roodman
What we know is that there are billions of people who are making their live – their living in what we call the informal sector. Legally speaking they don't exist, but they are running very tiny business activities whether they are giving motorcycle rides or selling food on the street. And they do that out of necessity. It's a matter of survival and most of those activities from what we know don't lead to business growth. They don't start to build up and hire people and become formal. So I don't want to say that it's a mistake to think that micro-enterprise is a dead end for poor people because this is absolutely – this is how a lot of people are surviving. But we should also recognize that never in history has a society gotten rich through supporting this kind of micro-enterprise.

Owen Barder
So, the image that we have of this woman who borrow some money in the morning to buy vegetables and take them to market and sell them and repay that loan at the end of the day or you described an example in the book of a woman who needs some money to buy – I think what she needs to make a basket.

David Roodman
Yes.

Owen Barder
And at the movement she is being ripped off because she is getting supply credit but all she can do is make \$0.02 a day on the basket. Now it sounds to me like for those people this is genuinely a big opportunity for them to be – have access to some other form of credit and be able to expand their stock and make more money. And that's the image that we have all been led to believe is effective. Now you are saying that that doesn't create a sustainable path for people to industrialization and to be lifted out of poverty. Is that right?

David Roodman
That's right and, by the way that story that you mentioned, that's actually kind of the origin myth or maybe true story of micro-credit because that's the story that Mohammed Yunus who started the Grameen Bank in Bangladesh who won the Nobel Prize. That's the one he tells of where the light bulb went on and he finally had this idea of giving loans to poor people. So that story and a million others like it are probably true, that there were people who were benefiting from getting a lower cost source of credit. So they are not being subject to usury from a supplier or a landlord. But then there are the others who go into the basket weaving business and because of the increase in supply of baskets, the price goes down and so everybody's made a little bit worse off and then there are people who go on to business that don't work – doesn't work out, you know, people who take a loan because her husband just got sick and needs to have his medical bills paid for.

Owen Barder
And you tell some quite distressing stories in the book of people who have taken out loans and maybe end up losing their house or having to sell their few assets because they have to repay the loan and the business hasn't worked out and…

David Roodman
That's right.

Owen Barder
…we all know people who have been in that situation in our own countries and obviously if you were in that situation in a developing country, your – there is no safety net for you. So people can be substantially worse off if they have taken out a loan that they shouldn't be taking out.

David Roodman
That's right. I mean depending on how you count there is something like 150 or 200 million people who now are using micro-credit. And so you know that that's going to happen sometime where people get in over their heads and they lose their house or something bad – really bad happens. So the question from a moral point of view, policy point of view, is this something that happens just once in a million? You know that's going to happen sometime. Or is it more like one in 20 or one in 10 we can't just dismiss it as an anomaly? And there is no firm answer to that question. But in meeting the anthropological studies written by people who have spent a month, for a year living in a village or a slum and watching the lives of people who are using these services, I didn't come away confident that we could dismiss it as something that was one in a million.

Owen Barder
Right. And just lastly on the evidence before we move on, I think there is a sense with some people who are involved with particular microfinance institutions to perhaps accept that what you are saying maybe true of the average, but to believe that their own organization is different that they have better mechanisms for selecting clients or for managing loans or their charges are sufficiently low that there seems to be a sense that this might apply to an average but it doesn't apply to the best cases. Did you find the evidence of that? Is your – would it be fair to conclude that what we should do is reproduce and propagate the best examples of micro-credit and stop doing the bad stuff?

David Roodman
So far, we have by my account five randomized studies of the impact of micro-credit and maybe now three of micro savings. And a bunch of those who came out since I froze the book so my book is already a little bit out of date. Although having seen most of them are reinforcing the earlier pattern and that's actually directly relevant to your question because if we are not seeing that one kind of micro-credit had – is lifting people out of poverty while another isn't, in fact, it's quite – it's remarkably a uniform pattern across rural Bosnia and urban India, and these other locations where the experiments have been done. In general, it's not of a short time crisis, one to two years reducing poverty although it is stimulating micro-enterprise. When I say "it" I mean micro-credit. The studies of micro savings are a bit more positive. It's a – one

response I have gotten to the book is, well, yes, there is some other kind of micro-credit or micro savings that hasn't been tested yet and that's the kind it works.

Owen Barder
Right.

David Roodman
And to which I say great, let's run the experiment and find out and prove it.

Owen Barder
You are listening to Development Drums with me, Owen Barder, and my guest is David Roodman and we are talking about David's book, Due Diligence. And we have discussed so far the evidence that microfinance doesn't seem to be on average a way to lift people out of poverty. And we are going to talk next about the other ways in which microfinance is important for poor people and then later on, we will talk about the experience of writing the book and about what kind of evidence matters. So let's move on, David, to the good that microfinance does and you have got a lovely story in the book about being in Cairo and the contrast between what you are seeing in your simulations on your laptop and what your eyes were telling you. Tell us about that.

David Roodman
Yeah. So when I started this work, I guess four, maybe even five years ago and there had been no randomized studies yet of the impact of micro-credit. So leading studies were non-randomized ones where lots of data was collected by surveying households and then very fancy mathematics was applied in order to distinguish correlation from causality to actually figure out what was causing what.

Owen Barder
Just to explain to people. So in other words, it's possible that people who take out microcredits do better, but that doesn't mean the fact that they have taken out microcredit is what's made them better. It might be that people who are more entrepreneurial in the first place take out microcredit and would have done better anyway. You don't know that microcredit has caused improvement in their income. So you are trying to use a statistical technique to establish whether the microcredit leads to being better off or whether there is some other relationship between that correlation. Is that?

David Roodman
That's exactly right. All really statistics tells us is what's correlated with what. You know, are better off households borrowing more? To then interpret that as causation, is microcredit making people better off or worse off, requires additional assumptions and it requires some effort to rule out the competing stories that you don't want to be true, like it's just better off people being more comfortable borrowing.

Owen Barder
Right.

David Roodman
And unless you've randomized the offer of treatment, which really makes it easy to tell what's causing what, it's difficult to figure out causality. And so fancier and fancier mathematical methods were developed over the last few decades was microcomputers made this easy. And so the most influential studies were also the most complicated and confusing.

Owen Barder
Right. So there you are sitting in Cairo, trying to understand this very complicated piece of math.

David Roodman
Yes, I'm trying to understand this thing by rerunning the study myself, writing my own computer programming and really understanding all those equations, and coming to doubt it, coming to think that actually we don't have evidence that microcredit is reducing poverty after all. And while I'm doing this I visit a microcredit program in Cairo run by, we call the Lead Foundation, it has a lot of funding from the

US Government. And they take me to one of their branches in a poor neighborhood on disbursement day. And, so, I go into the lobby of this little office and it's just absolutely packed with women and their children because they are going to be there for several hours waiting to get their new loans. And the crowd actually overflows down the hallway and down the stairs and on to the street.

Everyone is very excited, and then I get to meet some of the borrowers, like in the classical model from Bangladesh, that Mohammed Yunus made famous. They borrow in groups of five. And the women are responsible for each other's loans. So, if one can't pay the others are supposed to pay. So, through a translator, I got to talk to the borrowers and they told me what they were going to do with the loans. And it was all, what you would call, petty trade.

One woman was going to be buying and selling makeup to her friends and family, I think. And another, I think her sister was going to be doing the same thing with bed sheets and so on. I don't think these women were allowed to go out to the public spaces that much. They are using their social networks as a way of doing commerce. Now what they really were doing with the loans, I am not sure. They may have just been telling me this because they were required to say they were starting business together.

Owen Barder
They were in the office to get the loan.

David Roodman
And the loan officer was right there and translator worked for the lender, who knows what the truth is?

Owen Barder
Right.

David Roodman
But it seemed pretty clear to me that they wanted these loans and they were voluntarily coming to use this financial service to get a little bit more control over their lives. And I thought, you know, should I tell them that back in my hotel, on my laptop I had been running conditional recursive mix process progressions on a cross section of household data from Bangladesh. And I was beginning to doubt whether these loans were such a good idea. I realized who was I to tell them how to live their lives. So different from my own.

Owen Barder
Right. And so for them clearly that was something worth having. Even if the data is telling us that it's not lifting people out of poverty.

David Roodman
Right. And I very firmly believe as you do, as you have written so eloquently that it's important to have good evaluations done on what actually works and what doesn't work. And I was in the process of deciding what we knew. So how do I reconcile these two sort of disparate views. The sense that something was good was going on but the sense that we didn't have the evidence. And what I realized is that – and this kind of led to the analysis at of heart of the book, is that there were these three distinct notions of success in the conversation about microfinance, in the good books I was reading. One was the development – they corresponded with definitions of the word development. One was development, as escape from poverty, which is the one we've talked about. Microcredit is successful for those people out of poverty, that's development.

But then there is development as freedom, which is a notion that development – and this is goes to Amartya Sen, who wrote a book by that name. Development is about giving people more agency in their lives. That can take many forms. It can be – you get agency if you have higher income. And that's the traditional notion of development. But you can also get agency from higher education, better health, the right to vote, many kinds of freedom. And financial services, seemingly can give you freedom by helping you manage your financial circumstances. And then there is development as what I call industry building or economic transformation, which goes to the work of Joseph Schumpeter, an Austrian economist about 100 years ago who popularized the term creative destruction and emphasized that, what development is really about, what really reduces poverty over the long run is this process of constant economic and political transformation. It's very disruptive but ultimately makes most people better off.

Owen Barder
Okay. So we're going to come to that third definition of development, the Schumpeterian one. But let's focus on the second one, the development with freedom. And we had Daryl Collins and Jonathan Morduch on Development Drums talking about their book that they wrote, Stuart Rutherford & Orlanda Ruthven: Portfolios of the Poor, which is this analysis of what poor people do with money and in particular this insight that if you are living on less than a dollar a day, you are not actually living on less than a dollar – some number coming in each day, you are living on maybe $4 one day and nothing the next day or you have got a big income during the harvest season and nothing during the winter. The people actually – the poor people need financial services more than rich people, some kinds of financial services more than rich people. And one way the people can live better lives in developing countries is that they have access to these financial services that enable them to smooth their consumption across far low periods of income and enable them to cope better with disasters and make them more resilient and so on. And so is that the sense in which microcredit can contribute to that? Is that why women were excited in the lobby of the Cairo place? Is that what they are getting?

David Roodman
That's part of why. And in fact the reason I brought this conception of development as freedom into my book was precisely to embrace the work that you are talking about, particularly by Stuart Rutherford, who brought some earlier work in the same vein. So what I do in the book as I bring this notion, development is freedom to microfinance, I say okay, well does microfinance increase freedom or does it reduce or when does it do which. And when you start to think about it, there are lots of different aspects of freedom that we are talking about here.

So, one is the one that's really emphasized in Portfolios of the Poor. Does it help people manage the difficulties of their lives, pay the doctor bill when it comes in, save up for school fees and so on. And I think financial services inherently do that. I wouldn't say automatically or always, but inherently, that's what they are about. If your husband goes to the doctor and you need to pay that bill, you can pay for that with a loan, if you are in a pinch. You can pay it by drawing down savings. Maybe your son in the city will send home money, as a money transfer. Now, if you are really lucky you have got health insurance, you can pay for it that way. What that illustrates is that all financial services help people pull together money when they need it and are inherently about helping them get a control, getting more of a handle on their circumstances.

But there are other aspects of freedom that come up in looking at this. A lot of the idea – one big idea about microfinance is that it's been empowering especially for women. Say in a very sexist society like Bangladesh in the 1970s where women were formally prohibited from doing business in public spaces, going and buying and selling in the market. Whether they actually did that is not the question. But this was the norm. For women to be able to come together as a group in a public space and do business with real money was breakthrough for many of them. That's another conception of freedom that has to be brought in here.

But then there also – there's the negative side, when do loans entrap? You know this old question of what is usury, what interest rate is too high. So I survey all of this and I also talk about some other themes like transparency. It seems empowering if you can understand the true price of the credit you are buying. If there are hidden fees that confuse you, right. It's empowering if financial services are realizable. This is a theme that's emphasized in Portfolios of the Poor. Compared to borrowing money from your uncle or being in a savings group in your alley, microcredit is very reliable.

Owen Barder
Right, one of things in Portfolios of the Poor was this idea that people didn't want to be questioned about what did they need the money for. And people liked the impersonality of being able to borrow from an institution rather than from their friend or from their family.

David Roodman
That's right.

Owen Barder
And we can imagine that, right. It's nice really to have that conversation with your bank manager rather than to have to explain to your parents why you have run out of money at the end of the month.

David Roodman
Yes, right. That is empowerment.

Owen Barder
That's empowerment. But what's interesting is that for many people that isn't development, right and you are doing something smart by saying this is development as freedom. But there is this distinction that people draw between giving people access to health, to education, to clean water, to food as a subsidized service, as a service that they want, but many people think that as it were a kind of welfare transfer, but it's not a development – even if it's worth doing, it's not – and there are good reasons to do it, it isn't development. But what you are doing, is you are just helping people live good lives. And that's a perfectly sensible objective but it's not the same thing as having countries grow and develop.

David Roodman
Yes, and I would agree that it isn't.

Owen Barder
And one reason a lot of people like microfinance is that they think it's not – is that they thought it was investing in businesses and entrepreneurs and growth and this is permanent and sustainable and catalytic and yada, yada. And now you are saying, no, no, this is giving – this is a utility for people that we are giving them.

David Roodman
Right. I'm saying it's modestly useful. I wouldn't say that this is as valuable as say, the same money spent on providing clean water so a child doesn't die.

Owen Barder
Right, so I was going to ask you that.

David Roodman
Right. But where the strength can be that if you can build a mostly sub-financing institution that serves a million people with rather modest subsidy, then you are having a modest impact on a lot of people.

Owen Barder
Right, so for relatively small subsidy, say, then a lot of people have a significantly better life.

David Roodman
Right.

Owen Barder
Do you have any kind of cost effectiveness estimates, I mean it's quite hard to compare the utility that people get from being able to move their income from the utility they get from not having to walk eight miles to get clean water. But if we got any kind of sense of whether we should just spend that money on vaccines or water or whether providing access to financial services is a cost effective way of raising people's happiness?

David Roodman
It's a good practical question and my answer is no.

Owen Barder

Yeah, I get it. So – but it could well be, in the example you give, right if this is a business that's marginally unprofitable and we make it marginally profitable with a bit of a subsidy.

David Roodman
I mean, one of the reasons it's hard to answers is because any given microfinance institutions, what it costs to support it for an outside donor is a dynamic thing. It might cost a certain amount earlier, but then it might become profitable later on which gives us – I don't know if that's a negative cost or what, but…

Owen Barder
So you have about three chapters of the book which are quite analytical looking at the evidence of the impact of microfinance, but you've also got a long, I found very interesting, discussion about the history of microfinance in our own countries, in wealthy countries. And one reason I like it was that there was a discussion about Robert Owen, the Welsh social reformer, philanthropist in the 18th and 19th centuries who I would happen to be named after, Robert Owen. So I was glad to see his role in the story. But what I was interested in is this idea that you set out that the kinds of financial services that people like Grameen Bank introduced in Bangladesh were introduced at a much lower level of income per capita there, I think you said about a quarter of where those services began to emerge in our own societies. So is this an example of leapfrogging, they can take the technology, things have got cheaper, we know how to do it so they don't have to wait to – as we have seen in the health sector where people have access to good technologies much sooner inning as they become richer? Or is this an example of a technology that isn't yet sensible at those levels of income and that it will become an important part of the industrialization process but perhaps there are reasons why it isn't having the impact yet that you would want to see?

David Roodman
Well, it's both. I think that the services are more practical at lower GDP per capita than they were before. This time around they don't have to be invented first.

Owen Barder
Right.

David Roodman
And if you look at the history of bringing insurance, for example, life insurance to what were called the industrial tradesmen, the working class, that whole industry had to be invented and they weren't even sure about how to price things and so on. So clearly countries that are industrializing later can benefit from all that learning. And that is part of what happened with micro-credit. It wasn't invented in 1975 by Mohammed Yunus. He was influenced by models that were brought there by the British colonizers who in turn learned from Germans and so on.

Owen Barder
And in fact, Jonathan Swift in Ireland, I love that story.

David Roodman
That's right, yes. In the 1820s, Jonathan Swift was making loans of £10 or £20 to what you call industrial tradesmen and he didn't require collateral. They just had their two co-signers which was just like in these groups of five women who borrowed and are responsible for each other's loans. So these ideas are ancient. But history is – it is a good warning to those who think, well, we should just give the poor health insurance. You know it's really not practical when you are at $2 a day because you can spend more providing that insurance than is actually involved in the insurance policy itself and only when you get to a higher level of GDP per capita does it become practical.

Owen Barder
But I want to link this back to your Schumpeterian notion that you mentioned before that investing in these kinds of institutions, having an effect of microfinance, financial services industry is part of building the social capital that makes a country develop. Explain why it's important for industrialization to have these institutions.

David Roodman
Well, this gets to the third conception of development and success that I mentioned, development as an industrial transformation. I don't think that microfinance is turning its clients, as you said, into Schumpeterian heroes of creative destruction. They are selling more tomatoes or more sarees. But the institutions themselves, many of them are quite impressive. They are competing, they are innovating, they are hiring thousands, they are serving millions. And that is the essence of economic transformation. And so I think – I can't think of other examples where outsiders, social investors and donors and come in and created a whole industry in many of these countries that is geared towards delivering inherently useful services to poor people. So I think that they should be proud of that. I think, as we discussed, these services may not be transformative, but if at modest costs you can build up these institutions to serve millions, that is a reasonable success.

Owen Barder
Your book is mainly about microfinance rather than about aid and aid donors. I enjoy that about it. But I just want to focus on the role of aid in this last point you make because I have been worried for some time that if you have subsidies, external subsidies for these nascent financial institutions and for an industry that you actually crowd out the Schumpeterian creative destruction that you end up with businesses that ought to go bust and be replaced by a young upstart, continuing to get subsidies from DFID or USAID or the World Bank and instead of having creative destruction, you just have kind of rent seeking. You just have organizations that just get aid from somewhere and you don't get the innovation that helps them serve poor people better and you don't have the bad organizations going bust and the new businesses coming into the business. So if you think that the Schumpeterian story is an important part of what makes microfinance important, does that suggest we should be trying to subsidize less?

David Roodman
I think – well, that's our concern but you know, there is actually even worst form of it because credit markets are special, right? If we were talking here about building up the clothing industry, right, you could – everything you just said could still apply. But with credit you have got this peculiar thing where the more you sell, you know, if you try to sell too much clothing, there's a glut, prices fall, inventories built up and there is proper feedback. With credit if you try to shove a whole lot out, the market will absorb it and everything will look good for a while and then there will be an overshoot and a crash.

Owen Barder
Right, as we've noticed in our own countries in 2008.

David Roodman
Right. And it has happened with micro-credit in several countries such as Bosnia and Pakistan and Morocco and Nicaragua. And so that's actually the worst form of what's happened and it is something that concerns me. I think if anything there is too much money going into micro-credit now. We have to see less and that would be a double win because it would help put the microfinance industry in a more stable footing and would free up money to be putting into other things.

Owen Barder
Okay. So that's an important conclusion before we move on to the next session of our discussion, which is not only does microfinance not demonstrably, on average, lift people out of poverty, but also the support that we give it may also make it less effective in providing the other kinds of benefits that it might be providing in terms of building up a sustainable industry that does good for its people and doesn't do any harm.

David Roodman
Yeah, this is what I say, an oversupply of capital may actually be the greatest threat to the greatest strength of microfinance.

Owen Barder
Very interesting.

You are listening to Development Drums with Owen Barder and my guest is David Roodman, who is also a senior fellow at the Center for Global Development, but more importantly is the author of Due Diligence. We have talked about the role of financial services in development and particularly that the evidence so far is that microfinance has no impact on average on lifting people out of poverty but that it may do other beneficial things.

Now I just want to focus briefly now on this point about evidence and we got into it a little bit earlier but let's explore it a bit more because I think a lot of listeners to Development Drums will hear talk about randomized control trials and so on and this problem of causation. So perhaps you could – I think one of the things that I learned watching you talk about your book when you were recently visiting London was that people still struggle with some of these ideas. People still struggle with what – why this is important and what this – why this evidence matters. So tell us a bit about how and why the first randomized control trials for microfinance really began to shed light on an issue that otherwise would have been opaque?

David Roodman
Right. So there has been this movement which I think is very healthy in the last 10 years in development economics towards using randomization as a much sharper way to study the impact of things that we are delivering to poor people. And so the first – that movement sort of arrived at the doorstep of microfinance in the summer of 2009. We had the first two studies, one was done in – well, they are both done in cities. So they are both urban studies. One was done in Manila, in the Philippines and the other one was done at Hyderabad in India. The biggest caveat to both of them I think is that they studied impacts over a relatively short timeframe, 12 or 18 months. So we don't know what happens over the longer term yet. But they contradicted the most cited studies up to that point in finding no impact on how much money the households were spending, which is the basic indicator of poverty. How many kids were in school, how sick people were, these kinds of things, so just no real impact on.

Owen Barder
So the important insight here was the people who got loans and the people who didn't get loans, the only difference between them was the throw of a dice or the – is that right, is that what happened in both cases?

David Roodman
Exactly right, yes.

Owen Barder
So if you have got a large enough number of people who do get loans and a large enough people who don't get loans and the only reason you are among a group or the other is a throw of a dice. Then if it turns out that one group is doing significantly better than the other group, you have got to surmise that it's because they got loans

David Roodman
Or an act of God. One or the other.

Owen Barder
Right, let's not get there. Okay. So the randomization is helping us distinguish between the effects of the credit because that's the difference between the two groups from the other things that might determine whether or not people are getting better off because on average you would think that all those other things that would be driving people. You know, what's happening in the economy as a whole, where they are geographically, the size of their family, all those other things are going to be, on average, the same in these two groups. That's the reason why randomization mattered.

David Roodman
Exactly.

Owen Barder

So what was wrong with the old trials that this randomization problem fixed? Why were we seeing no effect in the randomized control trials that people were picking up in effect and the other kinds of evidence?

David Roodman
Most likely because there were some other story at work. So, for example, this – the study that I was delving into in such great length when I was in Cairo that looked at the impact of micro-credit in Bangladesh that found that households that were spending more meaning they were less poor, had also used more micro-credit in the last five years.

Owen Barder
Right. So there is a correlation between spending more and using more micro-credit.

David Roodman
I think…

Owen Barder
So presumably that correlation, they were controlling, I mean in the econometric terms. They were trying to control for all these other things, right? They had variables in there that said for a given family size or a given place or yada yada, presumably.

David Roodman
Yeah.

Owen Barder
Yeah.

David Roodman
Actually, as I think about it, this may be a bad example because, what I have discovered with this particular study is that there is – this are very technical problems, basically it's a kind of study where if you take out – there were 1,800 families in the study. If you take out the richest 14, who actually were enormously rich, in the sense that if you had looked at the distribution of wealth, as a sample, it was a bell curve except that were way off to the front or the right of the tail, one tail was too big. If you take them out and the study actually assumed that there was a bell curve here. So if we took them out in order to make the study meet its own assumptions, the result completely went away. They were actually…

Owen Barder
Okay. So there's a statistical error then in that case or something going on.

David Roodman
Yes, which was undetected. But in general, what my feeling is, I believe the correlations, but I don't believe that one causal story has been proved and all the others disproved.

Owen Barder
Right, okay. It seems to me that one of your great strengths, David, is that you are determined to understand what we can and can't conclude from these kinds of statistical correlations. And you've done great work in the area of the impact of aid on economic growth, where you've basically cast doubt on these studies that purport to show that countries that get more aid grow faster. And your conclusion isn't that aid is ineffective, it's just that – your conclusion is that we don't know. And in some sense your conclusion here is not that microfinance is always and everywhere ineffective. But that the evidence we have so far suggests that we don't know.

And I'm just wondering if you've just got a higher standard than everybody else for what we do and don't know, right. I mean to most of the rest of us, this looks like compelling evidence. And you are just a deep skeptic, and that's a valuable thing. But should the rest of us say, well, that's just David being super careful about what we – and sometimes there are lots of things we don't, know but it suits us to behave as if we do know, and then life goes on. Are you being too skeptical about what we know, or should we go with the flow and believe our eyes when people tell us that they have seen microfinance really making a difference?

David Roodman
Yeah, of the few things that I want to say is that, first before this is over I just want to emphasize that the studies have made – the impact of micro savings have been more positive. They are seeing people weathering shocks better, and having higher income and higher investment. So, I don't want to lose sight of that, that microfinance is not microcredit. And precisely because we do have this growing number of good studies, ones I believe, I wouldn't say that we don't know anything. We are getting some precisely measured zeros and some precisely measured numbers that are not zero. That are good impacts.

Owen Barder
So in a sense, that's the difference between the aid growth thing. That here, in the aid growth thing, we don't know. Here we do know and the answer is zero. Is that right?

David Roodman
Right. And the problem is we can never run a randomized trial on the impact of aid on growth. And so, whereas I can say with microcredit we don't know but let's just wait a little bit longer, and let's commission more good studies. We are always going to be kind of stuck with aid and growth that we won't be able to perform the randomized studies. And so there it is more valid to say, yes, David, but we have to go with what we know whether you trust it or not.

What I will say, is my own experience, from the day I started here, you know, I started here 10 years ago and started working for Bill Easterly, who was then at the center. And the first thing he had me do was get the data for this famous study on aid and growth by Burnside and Dollar with the World Bank which showed that aid worked in a good policy environment. And he had me rerun the numbers and add a few more data points and boom, the study – the results just went away. That was a really a formative experience for me, one that has been repeated a bunch of times, where I look into these non-randomized studies and almost invariably find problems. So my own experience, which I don't expect other people to buy into 100% is that you cannot rely on these things.

Owen Barder
Right, whereas randomization makes the mathematics much simpler, because essentially you can take these two groups, one with and one without, and just look at the averages, right? On average these people have a higher income than that, and the only possible explanation is that having the microcredit or whatever it is made a difference. So because the math is much simpler, you don't have this sensitivity to whether a particular data point is in there or not.

David Roodman
That's right. I see randomized trials as sophisticated in their simplicity.

Owen Barder
Right.

Owen Barder
This is Development Drums with Owen Barder and my guest is David Roodman. We have talked about the effects of microfinance and about the importance of rigorous evidence. And we are now going to spend the last few minutes of the podcast talking about the unusual way in which this book was written. So let's turn, David, to what you learned during the process of writing this book, about the process itself. Tell us what you did.

David Roodman
Well maybe I should back up. I don't know how many years ago it was when the man named Owen Barder came to CGD and told us we should blog.

Owen Barder

Which was just a big mistake. It’s a time sink.

David Roodman
And we said, what’s a blog, right? I remember you explaining to me that the author writes posts and everybody else can comment. I hadn’t understood that. So we started blogging here, and then three years ago I was working on the chapter on the history that we discussed earlier, discovering that there were all these old examples, Jonathan Swift and all the others back 200 years ago.

Owen Barder
Robert Owen, remember him.

David Roodman
Robert Owen, yes of course. And thinking well there must be a lot I'm missing, right. I'm just finding this by following footnotes and Googling stuff. What I don’t I know? Why don’t I share my draft on the web, so other people can tell me what I'm missing. And in discussions with Lawrence MacDonald, our communications director, we thought, well we should just put everything online and we got advice that we should not just put stuff online, but turn it into a real blog, that I should share everything. Share what I'm writing, share my discoveries, share my questions.

Owen Barder
I mean that’s a sharp contrast with the way normally people write books. You are going to sit in a dark room with your word processor, and you churn it out until it’s finished, and then you send it to the printers, and maybe an editor looks at it, but no one else.

David Roodman
Yeah and the sort of two step communication process where you spend a year preparing your message and putting it out there once, it can’t be changed and then people can respond seems rather archaic in the age of Twitter. Where you can have all this constant interaction. So it’s been a fantastic experience. It has allowed me to do many of the things that the book was designed to do in terms of helping me think, helping me teach others, signaling my expertise. It also allowed me to be much more agile in responding to events, and there have been a lot of events in the microfinance world in the last few years. And it improved the final product in several ways. I was able to test ideas and have them shot down. I was experimenting with my voice. I discovered, became more confident in writing in a more informal way. So I think you will see some of that in the book.

Owen Barder
And I just want to say for the people who haven't read the book yet, I was a bit daunted by picking up a big book about microfinance, because I'm interested, but I'm not that interested. I found actually it was a very good read. It’s full of interesting stories, it’s written in an informal style, it’s got a lot of you in it but it’s got a lot of people in it as well as a lot of numbers and tables and things. So if you are not sure whether to read Due Diligence, you really should get hold of a copy and have a look at it because I did give you a voice that made it very readable, this process.

David Roodman
Great. And if you are overseas and having trouble getting it, you could try getting the Kindle edition, which can be read on iPads and such. The main disadvantage for me was that on any given day it was much more fun to blog than to work on the book.

Owen Barder
So it slowed things down.

David Roodman
So, it took rather a year or so longer. And that was compounded by the fact that there was so much news. Mohammed Yunus was removed from his job and there was a big crisis in India. There was a lot to cover and keep up with as a blogger. So the blogging did take on a life of its own.

Owen Barder
But if you were going to write another book tomorrow on some new issue, you would do it this way or you would go back to the darkened room?

David Roodman
You know it's a good question. I think it depends on the natural audience. I was blessed here with working on a subject that lots and lots of people are interested in. If I was working on something much more arcane I might not do that.

Owen Barder
You've been listening to Development Drums with me, Owen Barder, at the Center for Global Development, and my guest has been David Roodman, the author of Due Diligence, An Impertinent Inquiry into Microfinance. David, thanks for coming on Development Drums.

David Roodman
It was a true pleasure.

Owen Barder
If you like Development Drums you should consider also listening to the Global Prosperity Wonkcast, a shorter, snappier podcast hosted by my colleague Lawrence MacDonald. You can find both Development Drums and the Global Prosperity Wonkcast on iTunes or at the Center for Global Development website.

I have got lots of interesting guests lined up for Development Drums. So if you want to pose a question to one of them, visit our Facebook page and put your question there. You can also suggest topics and guests for future episodes. Development Drums is produced by Anna Scott. Please look out for us on Facebook. But until next time, thank you very much for listening.