LITERATURE REVIEW

A. Infrastructure Development and Inclusive Growth

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**Adequate physical infrastructure provision is a condition for investment and economic growth.** The relationship between power generation and gross domestic product (GDP) growth is well established. For example, empirical analysis for 16 Asian countries during 1971–2002 found that although economic growth and energy consumption lack short-run causality, long-run unidirectional causality runs from energy consumption to economic growth.¹

2. 

Lack of reliable power supply is often identified as one of the major problems affecting production, particularly by larger firms and exporters. Policies that improve the access and reliability of electricity supply have an important impact on business development.² In fact, World Bank research using enterprise survey data from Bangladesh, the People’s Republic of China (PRC), Ethiopia, and Pakistan found that, even after controlling for firm characteristics and regional or country effects, power losses have a significantly negative effect on total factor productivity.³ In comparison, transport is usually perceived as less of a business constraint, although research on African countries shows that deficient transport systems can add to production costs and significantly reduce the competitiveness of firms.⁴ Other analysis using data from the PRC did not find a significant link between infrastructure and firm performance, which is likely due to decreasing marginal productivity of infrastructure given good infrastructure provision in the PRC study regions.⁵ This would indicate that the effects of infrastructure investments on firm productivity and performance are larger in countries or regions with poor infrastructure stock.

3. **Infrastructure development can play a major role in promoting growth and equity.** Through both channels it can help reduce poverty by enhancing access to productive opportunities by the poor and disadvantaged. For example, a recent empirical study by the International Monetary Fund (IMF) confirms earlier research findings⁶ indicating a link between better infrastructure, both in quantity and quality, and improved income distribution. The study concludes that this result, together with the proven role of infrastructure in enhancing productivity and growth, suggests that infrastructure development can have effects on poverty reduction and inclusive growth. Removing infrastructure gaps would increase potential growth and spread the benefits of growth more evenly.⁷

B. Finance Sector Development and Inclusive Growth

4. **Finance sector development promotes economic growth.** Research has shown that well-functioning financial markets facilitate the allocation of capital to projects that yield the highest returns


and thereby enhance growth rates.\textsuperscript{8} The literature on finance and growth has established an association between financial development and long-run economic growth.\textsuperscript{9} The link between the two is fairly robust. A 10 percentage point increase in the ratio of broad money to GDP was found to be associated with an acceleration in GDP growth of a quarter of a percentage point per year.\textsuperscript{10} Subsequent work has refined these findings and shown that the positive impact is channeled mainly through productivity gains rather than through capital accumulation itself. Analysis of data of firms confirmed a positive relationship between a firm’s access to finance and its total factor productivity.\textsuperscript{11} Moreover, research shows that higher access to finance contributes to productivity increases and growth of the individual firm,\textsuperscript{12} including through significant impacts on the rate of innovation.\textsuperscript{13}

5. **Evidence of finance sector development effects for inclusive growth is less clear.** Empirical research seems to confirm that finance sector development helps reduce poverty, showing that a 10 percentage point increase in the ratio of private credit to GDP leads to a 2.5–3.0 percentage point reduction in poverty incidence (based on both $1- and $2-a-day poverty lines).\textsuperscript{14} However, inherent methodological weaknesses are associated with cross-country analysis.\textsuperscript{15} Empirical evidence also shows that finance sector development supports the achievement of the millennium development goal targets by reducing income and gender inequalities and improving education and health services.\textsuperscript{16} A study using data for 58 developing countries during 1980–2000 shows that countries with better-developed financial intermediation (measured as the ratio of private credit to GDP) experienced faster declines in poverty and income inequality by disproportionately boosting the incomes of the poor.\textsuperscript{17} The results are robust to controlling for potential reverse causality and hold even when controlling for the average rate of economic growth, which suggests that financial development reduces poverty beyond its effect on aggregate growth. Other research using different data sets found that financial development may actually hurt income equality if the benefits of deepening accrue disproportionately to the rich, for example, in the context of weak institutions and governance as well as distorted incentives, which implies the need to improve institutions and broaden the poor’s access to finance.\textsuperscript{18}

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\textsuperscript{15} Econometric problems encountered by the cross-country studies include heterogeneity of effects across countries, measurement errors, omission of relevant explanatory variables, and endogeneity issues.


C. Microfinance and Inclusive Growth

6. **Microfinance might not help the poor.** Support for microfinance is founded on the assumption that it reduces poverty essentially by enabling poor households and microenterprises to build more assets, increase income, better manage risk, and smooth consumption to avoid deprivation in lean times. A seminal paper by Pitt and Khandker (1998) and Khandker’s (2005) follow-up report use panel data from Bangladesh to show that access to microfinance contributes to poverty reduction, especially for female participants, and to overall poverty reduction at the village level. These sources have long been cited as empirical proof that microfinance—specifically microcredit—reduces poverty. These findings were refuted, however, in a 2009 paper (revised in 2011) by two respected researchers and microfinance proponents (David Roodman and Jonathon Morduch) who discovered a flaw in the empirical methodology used by Pitt and Khandker. When they corrected for the error and reanalyzed the data, no appreciable evidence for poverty reduction effects for micro loan customers was discernable. These authors also reviewed the results of randomized controlled trials in India, the Philippines, South Africa, and Thailand to conclude “that 35 years into the microfinance movement, evidence in favor of the proposition that microcredit reduces poverty is extraordinarily scarce.” However, in 2011, Morduch noted that “not being able to prove that it works” is not the same as “proving that it doesn’t work.”

7. Duvendack et al. 2011 looked at 2,643 reports assessing the impact of microcredit and analyzed 58 in depth. They also found no evidence of poverty reduction benefits. Unlike Morduch (2011), Duvendack et al. suggest that the lack of empirical proof indicates microcredit does not produce poverty reduction benefits for the poor. Still other experts point to the use of multilateral financial institution (MFI) loans as an alternative to higher-priced moneylenders, citing client demand as proof of benefit, although several prominent economists reject this idea, arguing that people often pay for goods and services with no positive welfare effects.

8. **Several studies show that access to finance does not necessarily translate into greater empowerment of women.** Most women never touch the money that is lent in their name; they hand it over to their husbands. Research done in Bangladesh since 1996 indicates that the majority of women with access to microcredit are not nearly involved enough in the handling ofmicroloans to achieve any sort of “empowerment.” On the contrary, many women experience an increase in domestic violence following their first loan due to ensuing power struggles in the home. Of the women in a study of Indian microfinance clients, 18% had full control over their loans and ran their own microenterprises, and 49% said that they wanted to be the one to take the loan even if they were only partially in control of its use after disbursal. The study concludes that the best outcome for women at this stage may be for commercial MFIs to shift to a more gender-balanced portfolio, targeting only those women with a reasonable chance of using the loan themselves, while leaving financial


24 Most notably by Anne Marie Goetz and Rina Sen Gupta and later by Aminur Rahman.

empowerment of the most oppressed to those institutions willing to dedicate resources to holistic support.

9. Recent rigorous impact evaluations show some positive income and employment effects of microfinance for the less poor. The debate over whether microfinance reduces poverty is moving toward the use of random controlled trials (RCTs) to take a much more nuanced look at what types of financial services benefit different groups of low-income households (whose members may or may not have microenterprises), and under what circumstances. For example, a 2008 RCT in South Africa compared borrowers to nonborrowers to determine the impact of relatively expensive payday loans. These loans were extended to marginally creditworthy borrowers who had initially been rejected by the lender. The study found that 1 year later, borrowers were more likely to be employed and had higher incomes than their nonborrowing counterparts. The data suggests that these types of relatively higher-priced consumer loans to riskier borrowers helped them recover from unexpected shocks—like sickness or damage to personal transport—that otherwise would have forced them to stop working (and presumably risk losing their jobs). Other recent RCTs show that certain types of savings instruments with restrictions on withdrawals have led to increased income or spending among female clients of MFIs in Kenya and Malawi, and liquid savings accounts appear to have helped women in Chile smooth consumption. So, while there is no rigorous empirical support for the assumption that access to microfinance services in general benefits poor people, new evidence is beginning to help identify the types of products that help specific groups of clients, and under what circumstances. Moreover, the less poor appear to benefit from microfinance rather than the ultra poor, who are usually not reached by most MFIs. The Independent Evaluation Department’s impact evaluation of two microfinance projects found limited outreach to the poor and limited effectiveness of Asian Development Bank microfinance support.

26 The sample comprised 787 rejected loan applicants that “had been rejected under the Lender’s normal underwriting criteria but not found to be egregiously uncreditworthy by a loan officer.” For a summary of the study: http://www.povertyactionlab.org/evaluation/small-individual-loans-and-mental-health-south-africa
29 Fewer than 15% of clients under one program and fewer than 1.5% of clients under another program lived below the national poverty lines. The study yielded some evidence of positive effects on household income and employment in household enterprises, but no direct impacts on household labor force participation in the formal sector or on other higher-order household welfare outcomes related to risk-coping behavior, children’s education, and household health compared with a counterfactual of no intervention. Source: ADB. 2012. Special Evaluation Study: Microfinance Development Strategy 2000—Sector Performance and Client Welfare. Manila.