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Group versus individual liability: Short and long term evidence from Philippine microcredit lending groups^{1†}

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ARTICLE INFO

Article history:
 Received 10 April 2012
 Received in revised form 1 November 2013
 Accepted 11 November 2013

Classification:
 JEL
 O11
 O12
 O13
 O14
 O17

Keywords:
 Microcredit
 Group lending
 Group liability
 Peer pressure
 Social capital
 Micro-entrepreneurs
 Micro-entrepreneurs
 Access to Finance

ABSTRACT

Group liability in microcredit programs to improve repayment rates through peer screening, monitoring, and enforcement. However, it may create excessive pressure, and discourage reliable clients from borrowing. Two randomized trials tested the overall effect, as well as specific mechanisms. The first removed group liability from pre-existing groups and the second randomly assigned villages to either group or individual liability loans. In both, groups still held weekly meetings. We find no increase in short-run or long-run default and larger groups after three years in pre-existing areas, and no change in default but fewer groups created after two years in the experiment areas.

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1. Introduction

Group liability is often cited as a key innovation responsible for the expansion of access to credit for the poor in developing countries (Armendáriz de Aghion and Morduch, 2010; Daley-Harris, 2009; Morduch, 1995). This credit delivery program to solve a credit market failure by mitigating adverse selection and moral hazard problems while facilitating mutual insurance. Under group liability, clients have an incentive to screen other clients so that only trustworthy individuals with good projects are allowed into the program. In addition, clients have incentives to make sure that loans are repaid, and that effort is exerted. Finally, repayment enforcement is enhanced as clients face both legal and peer pressure. Thus, by effectively shifting the responsibility of certain tasks from the lender to the clients, group liability claims to overcome lender market imperfections typically found in credit markets, especially for poor households without collateral.

^{††} We are grateful to the World Bank Research Committee, the National Science Foundation (CBET07035494788), and the Bill and Melinda Gates Foundation through the Financial Access Initiative for funding the analysis. We thank the editors, Marianne Chant, and the referees for their helpful comments. We thank Steve Levitt, Jon Eakin, Morduch, Karla Hall, Ravi Johnson, Jonathan Morduch, Mark Schreiner, Chris Foltz, Bruce Haggild, Dean Yang, and an editor and several anonymous referees for their comments on this paper. We thank John Coatsworth for the ICGD Philippines Micro-entrepreneur Accessing Finance Program for helping to coordinate the project and the other ICGD partner leaders at the Ministry of Finance for collaborating on the field work. We also thank Governor De Guzman, Senator Marjales, and Melissa Toledo for support research assistance. We thank Oscar Andaya, Gerard Guillen, Sudy Manilla, Marianne Whelan, and the staff of the World Bank for supporting the experimental program.

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<http://dx.doi.org/10.1016/j.jdeveco.2013.11.002>

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Group liability in microcredit purports to improve repayment rates through peer screening, monitoring, and enforcement. However, it may create excessive pressure, and discourage reliable clients from borrowing. Two randomized trials tested the overall effect, as well as specific mechanisms. The first removed group liability from pre-existing groups and the second randomly assigned villages to either group or individual liability loans. In both, groups still held weekly meetings. We find no increase in short-run or long-run default and larger groups after three years in pre-existing areas, and no change in default but fewer groups

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March 01, 2014