

Impact of Microfinance on Schooling: Evidence from Poor Rural Households in Bolivia

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Summary. — Channels for the influence of microfinance programs on a rural household's demand for schooling are identified: income growth, risk management, child-labor demand, gender empowerment, and parent information. Within a random-utility framework, a model of household consumption, investment in education, and borrowing suggests determinants at the individual, household and regional levels of the probability of schooling gaps. Using data from two surveys of households of clients of microfinance organizations in Bolivia, regression models examine determinants of schooling gaps. Inferences about otherwise positive microfinance impacts identify potential negative effects of increased child-labor demand, which challenge usual assumptions and pose dilemmas for policymakers.

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1. INTRODUCTION

Human capital formation is expected to play a major role in the reduction of poverty, a significant challenge for this century (Bils & Klenow, 2000; Krueger & Lindahl, 2000). In the rural areas of developing countries, however, access to education is limited (Barro & Jong-Wha, 2000). Some have highlighted supply constraints, due to missing infrastructure and resources (e.g., schools, teachers, and materials). Low schooling achievements also reflect effects on the demand for education of the household's preferences and budget constraints and of competing demands for the children's time. In turn, these determinants may be influenced by access to microfinance.

Financial services (loans as well as facilities for deposits, payments, and remittances) allow households to more fully take advantage of productive opportunities, facilitate consumption smoothing (given seasonal income flows), and offer tools for coping with risk, when ad-

verse shocks occur (Sharma & Zeller, 1999). Typically, however, information, incentive, and contract enforcement problems constrain the access of poor rural households to formal financial markets (Conning & Udry, 2007). Moreover, because human capital cannot be seized in case of default, it cannot be used as

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collateral. Consequently, the poor must fund their education out of past wealth or through abstention from productive work or from current consumption rather than with loans. Thus, financial market shortcomings accentuate a joint causation between income generation and human capital formation. Combined with increasing returns to investment in education, these shortcomings generate poverty traps (Bardhan & Udry, 1999).

Using innovations in lending technologies, microfinance institutions (MFIs) offer credit and sometimes deposit facilities to segments of the rural population otherwise without access to formal finance (Armendáriz de Aghion & Morduch, 2005; González-Vega, 2003). These innovations allow households without traditional collateral to pledge their reputation in the community or the present value of their relationship with the MFI—a value based on their human capital and future ability to generate income as well as on the sustainability of the MFI—as an incentive to repay loans.

The purpose of this paper is to evaluate the impact of microfinance on human capital formation by looking at whether children from rural households with access to credit or credit-cum-education programs are kept in school longer than children from households without access to these services. Building on various strands of the literature, we identify five channels through which microfinance may influence human capital formation.

Given a positive income elasticity of the demand for education, increased household income—a potential outcome of access to microfinance—should result in higher schooling expenditures. Further, if the higher productivity of educated household members is rewarded with higher incomes and wages, production and employment opportunities—including those in household microenterprises—should also influence schooling decisions (Behrman & Knowles, 1999; Duryea & Pagés, 2002). Low *per capita* incomes imply, however, high opportunity costs of keeping children in school, given their labor-supply potential. Moreover, if the marginal utility of income is higher for the poorer than for the richer, this opportunity cost should be higher for poorer households.

Child labor is demanded both for participation in income-generating activities and for taking care of younger siblings, which allows productive household members to work. This demand will be stronger when there are unexpected shortfalls in income. Thus, growing in-

come levels should have a positive influence on schooling, while adverse income or expenditure shocks should have a negative effect. All these effects lead to the identification of several channels of influence of microfinance on schooling.

First, if access to microfinance services influences the growth of household income, microfinance will positively influence the demand for schooling (*income effect*).

Second, adverse exogenous shocks force rural households to engage in risk-coping strategies that may require pulling children from school. Income volatility does not allow sustained enrollment over time because either school expenses can no longer be afforded or the children are needed to earn extra income (Beegle, Dehejia, & Gatti, 2006; de Janvry, Sadoulet, & Vakis, 2006; Jacoby & Skoufias, 1997). Missing loans, deposit facilities, and insurance, as potential remedies for risk, result in costly income smoothing strategies, such as diversification and migration (Morduch, 1995), while households smooth consumption by using financial savings, selling assets, taking children out of school, and developing informal insurance and credit arrangements (Gomez-Soto & González-Vega, 2007; Kanbur & Squire, 2001). Access to financial savings or to credit—particularly when emergency loans are offered, such as those from the internal account of village banks—reduces the probability that children will be pulled from school (Casabonne, 2006). If access to microfinance improves a household's ability to cope with shocks, it may positively influence the demand for education (*risk-management effect*).

Third, compared to men, women show a stronger preference for educating their children (Behrman & Rosenzweig, 2002). If preferences are gender-related and microfinance improves direct access to loans by women, thereby changing their power to influence household decisions, the rate of human capital formation may be affected (*gender effect*). This approach substitutes a bargaining process within the household for the unitary model of optimization of a single preference set (Haddad, Hoddinott, & Alderman, 1997). The outcome reflects gender differences in both preference functions and the power to influence household decisions (McElroy, 1997; Nanda, 1999; Swain & Walentin, 2007).

Fourth, given uncertainty about the future, imperfect information about opportunities, and high private discount rates, the schooling

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