much broader than Madison thought. The debate over federal court jurisdiction that LaCroix focuses on was just one part of this broader conflict over the scope of federal authority under the Constitution.

There is also a second potential flaw in LaCroix's "ideological" theory of the origins of American federalism. In stressing ideology, LaCroix may underrate the importance of economic and political interests. For example, American objections to parliamentary authority in the 1760s were at least partly the result of a reluctance to pay the more onerous taxes imposed by the British to finance the debt created by the Seven Years War. Absent this material interest, it is not clear whether proto-federalist ideology would have attracted as much support among the colonists as it did. Similarly, one wonders to what extent Federalist support for broad federal authority in the 1790s was influenced by the fact that they controlled the presidency and Congress during this period; Democratic Republican opposition may, in turn, have resulted in part from their status as a minority party at the national level. There were also important interest groups that had a stake in the Bank of the United States, the assumption of state debts, and other early federalism-related constitutional controversies.

To her credit, LaCroix acknowledges that her ideological theory is merely a supplement to institutional and interest group accounts, not a complete replacement for them. She is surely right to argue that ideology has at least some independent significance. But it would have been helpful to outline the extent to which ideological motivations interacted with material interests in producing the institutions of early American federalism.

Despite these reservations, LaCroix's book makes a valuable contribution to our knowledge of the origins of American federalism. The issues that she identifies remain relevant to this day.

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The Economics of Microfinance
Beatriz Armendariz and Jonathan Morduch
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It is one of the sad facts of recent human history that the economic prosperity enjoyed by so many remains unknown to most of the

rest. The causes of poverty have long been debated and much has been spent in the effort to ameliorate it. Reliable estimates suggest as much as $2.3 trillion has been spent over the last several decades, most of it in the form of sponsored aid programs conceived and pursued by governments and large foundations in developed countries. Despite this investment, however, poverty remains widespread and has worsened in many places, especially in Africa. These basic facts now fuel a vigorous debate over the scale and ultimate value of traditional aid programs and a search for more effective solutions.

Against this backdrop microfinance stands out as a private sector market-based strategy to improve the lives of the poor. Predicated on the assumption that even the poorest have the ability to improve their own circumstances given appropriate resources, microfinance seeks to overcome the barriers that deprive them of access to critical financial services taken for granted elsewhere. What began more than 30 years ago as microcredit for the poor has since grown into a large industry that increasingly seeks to offer savings and insurance products as well as unsecured loans to those otherwise overlooked by established financial institutions. *The Economics of Microfinance* offers a comprehensive exploration and analysis of the underlying theory of and research into the business of microfinance, covering a range of issues relevant to investors, managers, and researchers. The book looks broadly at four sets of issues: barriers that prevent established banks from providing services to the very poor, innovations that microfinance institutions (MFIs) have relied upon to overcome these barriers, the potential and consequences of MFIs becoming fully commercial enterprises, and the ultimate impact of microfinance on poverty and gender equality.

The poor have always borrowed and saved. They borrow from friends, employers, family, and village money lenders. They save by hiding cash or depositing it with friends. And in most parts of the world they can join one of a variety of informal rotating savings and credit associations. At the same time commercial banks face significant obstacles to serving poor customers. Where legal systems for enforcing contracts are especially weak, making a large number of very small loans without collateral means significant risk and high transaction costs. To succeed, microfinance must overcome these barriers while offering value not otherwise available through traditional savings and credit mechanisms. This book provides

an excellent theoretical and practical analysis showing how key innovations such as group lending models and innovative contract terms address these barriers. They also consider the key issue of high transactions costs and inefficiency that still make for relatively high interest rates. Most of this territory is well understood and uncontroversial, but perhaps not as well appreciated as it should be. Other aspects of microfinance, on the other hand, remain the subject of often intense debate.

Today microfinance institutions number in the thousands. Some have achieved significant scale; most remain relatively small. Most begin as philanthropies, usually organized as NGOs, often financed with grants from foundations or private individuals. If successful they can ultimately access commercial credit and potentially even sell shares to raise capital. As such, there is an inevitable tension between a social mission to ameliorate poverty and pressure to increase profits to attract capital and make the institution self-sustaining and independent of donor support. Increasing profits often means targeting better-off customers with larger loans to reduce risk and lower transaction costs, referred to in the industry as "mission drift." Whether and to what extent mission drift is an inevitable consequence of reliance on commercial sources of capital is still an open issue, one that potentially undercuts the claim that microfinance can ultimately succeed as a business. Notwithstanding that some MFIs have achieved significant scale, most MFIs are still subsidized to some degree, directly or indirectly. Whether they can ultimately fulfill the goal of serving the very poor without reliance on subsidies, or indeed whether microfinance actually has a determinative effect on reducing poverty, are large issues still very much debated, often in the absence of meaningful data. Here Armendariz and Morduch provide a nuanced analysis of the arguments, examining both the value commitments underlying different positions and discussing methodological issues complicating research into various claims. In particular, discussion of the use of randomized trials is a very useful introduction to one of the most important current trends in evaluation research.

Reliance on subsidies is often defended as a means of enabling otherwise well run and profitable MFIs to serve poor customers they might not otherwise be able to serve. Because they are often indirect and hidden, subsidies are often difficult to quantify. Moreover, because they offset costs generally, it is difficult to assign

any benefit to a particular segment of customers. Open questions include not only whether subsidies are ultimately essential but also how subsidies impact the overall supply of credit and interest rates. In keeping with their generally moderate view, the authors argue for a middle ground: "From a theoretical vantage, the argument for using ongoing subsidies is solid, and, in practice, well designed subsidies may be easy to implement and effective for borrowers" (p. 332). Yet they acknowledge that sufficient data are lacking and much more research is needed, as well as improvements in financial reporting to ensure full and accurate disclosure.

While it is at least theoretically possible for an MFI to become self-sufficient relying only on retained earnings from the loan portfolio, in practice this is rarely if ever sufficient to enable the institution to grow and expand. If not subsidized by grants and gifts, the institution must look to commercial credit, equity investment, or savings. Of these the last is perhaps most important though it has not been the subject of much attention. A move to accept savings means becoming a regulated financial institution, a barrier that most MFIs cannot overcome. Yet, there is increasing evidence that savings are if anything more important than credit to alleviating poverty and to the long-term viability of microfinance. The authors provide too scant a treatment of a subject critical to the future of microfinance, especially the potential impact of different regulatory schemes and the potential for regulatory innovation to encourage growth in savings-led microfinance.

Despite much anecdotal evidence supporting microfinance, there have been few rigorous studies able to establish conclusively that microfinance is determinative in lifting people out of poverty. Though clearly sympathetic to the cause of microfinance, Armendariz and Morduch are careful to note the limitations of current research and to highlight the challenges going forward. While randomized trials are clearly the gold standard for research, they are exceedingly difficult and expensive to conduct, especially when there are legitimate questions about how applicable the results of any study can be given the wide variation in local contexts and MFI business models. Even though vested interests are prone to dismiss any research that questions the value of microfinance, this research is essential. Governments may have a tendency to support programs that do not live up to expectations, but private investors (and, increasingly, well-run foundations also) do not.

Any research that illuminates clearly the long-term impact of microfinance activity can only serve to direct scarce resources to the most efficient uses and pressure microfinance institutions to adapt their products and practices accordingly.

One aspect of microfinance largely overlooked by the authors is the impact of technology. New mobile payments schemes such as M-PESA in Kenya, as well as access to scalable robust back office systems for managing loan and savings portfolios, have the potential to drive down transaction costs dramatically and reshape business models in an industry that is still heavily reliant on manual processes and face-to-face transactions. While it is perhaps too early to undertake a definitive evaluation of the impact of these technologies, it is not too soon to consider the possibilities and lay out a research agenda (as the authors have done in other areas).

For anyone seriously interested in the economic underpinnings that account for the success of microfinance to date and who wants a clear sense of the issues and controversies facing microfinance going forward, *The Economics of Microfinance* is well worth the investment.

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