Referee: 1

Comments to the Author
Summary

The authors propose an explanation for the low takeup of microcredit grounded in risk aversion. They show that, when investment increases the probability of a payoff (keeping the payoff size fixed), investment choices tend to be all or nothing: invest little or nothing, or go to the other corner and invest as much as possible. The authors test the key predictions of their model using an online experiment with respondents in the Czech Republic.

Comments

1. The authors argue that “nonconvexities … are inconsistent with the evidence’ (p4). These conclusions are not entirely consistent with several recent papers. One paper finds clear evidence of an S-shaped curve in the response to an asset transfer in Bangladesh (Balboni et al. 2022). Another uses an experiment in Uganda to show that a significant share of households are risk-loving – choosing a riskier lottery with a lower payoff – and that they use the proceeds to invest in lumpy land purchases (Kaboski et al 2021). A third paper finds that, in India, the long-term results of a randomized control trial are consistent with poverty trap dynamics for existing entrepreneurs, for whom microfinance is able to facilitate exit from a poverty trap (Banerjee et al 2021).

Additionally the authors argue that nonconvexity explanations “do not explain why the poor leave high return investment opportunities unexploited when they do have access to credit.” However, as in the cases above (cows, land, lumpy business investment), this appears to be precisely because these investments are lumpy. In the case of Banerjee et al, they authors calculate that microcredit is not sufficient to lift the poorest half of households out of the poverty trap, but is nonetheless able to do so for those above median initial wealth.

Of course, a poverty trap may be present in some settings and not others – and, as argued by Banerjee et al 2021, for some individuals and not others – so this is not to deny the possible role of risk aversion as the authors argue. However I think some discussion of these papers would be helpful.

Related, if the authors were to decide to carry out additional experiments, it might be interesting to “horse race” the predictions of a model with nonconvexities against those of the risk aversion model. If support for both models was found, the authors could then say something about the relative shares of “never takers” who appeared to be constrained by each channel.

2. The experiments carried out do not feel tightly tied to the setting of microcredit. The sample is a representative sample of Czech households, who are substantially better-off than a typical microfinance borrower. The sample also does not appear to be selected to contain a high share of current or aspiring entrepreneurs, which is the sample where both fixed-cost dynamics and risk-aversion dynamics might be particularly important.

3. The possible outcomes in the online games used to test the predictions range from 0 to 270 CZK. (The risk aversion elicitation has a higher possible payoff but a lower chance of a payout.) Average monthly income in the sample is 35484.6 CZK. As such, these stakes seem too low for risk aversion to be at play. (Of course this issue is not unique to this experiment (Rabin 2000) but nonetheless some discussion would be interesting.)

4. Given the “all or nothing” prediction of the probability game predicts a split by risk aversion, I was expecting to see a test of whether those with higher estimated risk aversion were more likely to invest nothing while those with lower higher estimated risk aversion were more likely to invest everything. Does this prediction hold? (Apologies if this is tested and I missed it.)

References

Balboni, C., Bandiera, O., Burgess, R., Ghatak, M. and Heil, A., 2022. Why do people stay poor?. The Quarterly Journal of Economics, 137(2), pp.785-844.

Banerjee, A., Breza, E., Duflo, E. and Kinnan, C., 2021. Can microfinance unlock a poverty trap for some entrepreneurs? (No. w26346). National Bureau of Economic Research.

Kaboski, J., Lipscomb, M. Midrigan, V. and Pelnik, C., 2021. How Important are Indivisible Investments for Development? Experimental Evidence from Uganda. w29773, National Bureau of Economic Research.

Rabin, M. "Risk Aversion and Expected-Utility Theory: A Calibration Theorem," Econometrica 68(5), 1281-1292, September 2000.