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several generations away from individual farming, which is far different from the situation in China, where communes were introduced in the 1950's

Speed and type of land reform in the former Soviet republics will vary among and within the separate states A great deal of research needs to attend policy changes there, especially since few collective and state farmworkers have indicated a preference for private property Workers in collective agriculture have become accustomed to a system of wages, perquisites, and 8-hour days What will happen when enormous agricultural subsidies are eliminated and agriculture is privatized is anybody's guess

An imaginative combination of private individual and group-held farms may work well, provided former collective and state farm members have a voice in matters of reorganization, unhindered by present farm administrators One can easily foresee some of the large farms in Kazakhstan surviving as subsidies are cut, while in the Ukraine much more family farming might result Also, there is need to reform input and output markets so the growing private sector can be serviced Today this sector sells its products (and buys its inputs) through the collective sector (which takes its bite and thus dampens private-sector incentives) Other troublesome facts are that to date the incipient private farming movement in the former Soviet Union is concentrated on inferior land, and it lacks capital resources and extension help

The message from this collection of essays is that no one model exists for agrarian reform, and reforms are by nature untidy Post-reform tenure patterns need to be shaped to local conditions, history, and factor markets Also, there must be close correspondence between effort and income received Farm-level incentives are important, but so is post-reform attention to inputs, services, and technology that will stimulate production The unfortunate truth is that often more political mileage can be obtained from distributing land than from assisting beneficiaries on that property to increase their production and thereby their incomes I would have liked information from microstudies, as in the chapters on China, Brazil, and Kerala More emphasis on income distribution and employment creation would have helped, though I realize that little such information is readily available

## Philippines Offer Refreshing Perspective on Rural Credit

***Informal Credit Markets and the New Institutional Economics: The Case of Philippine Agriculture.*** *By Segrario L Floro and Pan A Yotopoulos Boulder, CO Westview Press, 1991, 146 pages, $23 50*

***Reviewed by William F. Hyde***

In the foreword to this tidy little book, Joseph Stiglitz points out that rural credit has become a priority issue for economic development The general focus of concern is with the availability and terms of rural credit, and with government's failure to drive informal money lenders from the market for rural credit Floro and Yotopoulos provide an empirical assessment of rural credit within the framework of information economics (the New Institutional Economics) They justify this framework on the grounds that information imperfections are pervasive and important in less-developed and rural areas

The book begins with testable propositions about the price-quality theorem of credit markets in developing countries This theorem states that an increase in the rate of interest for the purpose of equating supply and demand is likely to affect loan quality by reducing the probability of repayment [1] That is, high-quality borrowers will seek credit elsewhere or depart from the market altogether, leaving only borrowers who are more likely to default on their obligations Furthermore, high interest rates are more likely to attract borrowers with risky projects and greater probability of default Together, these effects imply that the expected returns on loans do not fully compensate for increasing the interest rate The result must be credit rationing among borrowers who are otherwise indistinguishable to the lender

Floro and Yotopoulos use ANOVA and regression techniques on a survey of 111 agricultural borrowers and lenders from three provinces in the Philippines to test these propositions Their results point out that both lenders and borrowers are heterogeneous, that the formal terms of credit (interest rates, collateral) do not necessarily rise with the default rate on loans, and that lenders from the for-

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[1] J E Stiglitz and A Weiss, "Credit Rationing in Markets with Imperfect Information," *American Economic Review*, vol 71, no 3, pp 393-410

mal and informal credit sectors both have the same problems of sorting information, providing incentives, and enforcing repayment Formal sector lenders, however, are at a greater information disadvantage in any local community The authors conclude that formal and informal sector lenders are complements, not the substitutes usually assumed by central governments, international development agencies, and many neoclassical economists

This intuition is refreshing and enlightening to me, as a student of development and of the Philippines I rapidly became an enthusiastic reader of this book

Floro and Yotopoulos's empirical investigation goes beyond price adjustment and collateral requirements They ask what completes the sorting of heterogeneous borrowers in competition among heterogeneous lenders They begin by explaining that risk originates with the borrowing (not lending) operation of formal financial institutions That is, institutions using expensive money must charge higher lending rates This leads them to adverse selection of risk and to increased probability of borrower default Thus, we observe in U S S&L's and in the Philippines since deregulation in 1981 unanticipated adverse selection of risk in bank borrowing and moral hazard in lending—and bank failures

The authors then formulate tests to support their propositions, and follow with their empirical results and policy conclusions I do not know the New Institutional Economics (NIE) well enough to judge their success in terms of it NIE aside, however, their evidence did improve my understanding of informal credit markets

Floro and Yotopoulos observed four general classes of actors in the rural credit market, two lender classes and two borrower classes **Trader-lenders** (formal market lenders) avoid adverse selection of risk For them, the lending rate is a decreasing function of borrower income and an increasing function of the perceived probability of default **Farmer-lenders** (informal lenders) may prefer risk if it increases their opportunity to obtain the borrowers' defaulted property Their lending rate can be an increasing function of borrower income **Wealthy borrowers** generally find credit in the formal market **Poorer borrowers** generally rely on the informal market

The authors also observe that the formal sector (trader-lenders) has limited funds to lend and incomplete information on local borrowers The formal sector has better information on the creditworthiness of wealthy borrowers Some wealthy borrowers become farmer-lenders, and they have the advantage of knowing their community better than the formal lenders Therefore, they are in a better position to know the creditworthiness of poorer borrowers Furthermore, credit rationing in the formal sector alters the size of loans but does not alter the identity of the borrowers Large farmers continue to be the formal sector borrowers The only effect on them, as rationing becomes more constrained, is that they obtain lesser amounts of credit per borrower

This sequence of observations suggests a layering of formal and informal financial institutions, and the author's residuality hypothesis When credit is rationed, personal relationships in the informal sector manage the adverse selection of risk The informal sector completes the sorting of scarce investment capital

The policy implications are that the formal and informal sectors are complements Where credit becomes the key to increased agricultural inputs (therefore, increased output), the informal sector plays a beneficial role by reaching borrowers that the formal sector cannot The more distressing policy implication is the negative equity consideration Large farmers may use their second role as farmer-lenders to encourage high-risk activities, leading to subsequent default by small farmer-borrowers

I have always found the study of financial institutions tedious Perhaps the tedium is explained by the propensity of most work on rural credit to explain the history of local institutions and public action without creating a conceptual organization for the obvious layering of the formal and informal lending sectors Floro and Yotopoulos filled the void for me Their thesis and my intuition would argue that the very high terms of credit observed in rural areas and developing countries are indicative of the critical nature of the credit input to rural economic activity

I am unsure that the authors need all the nice words about the New Institutional Economics They have created a tightly organized, readable, intuitively satisfying, and rigorous discussion of the principal actors in the Philippine market for rural credit We might anticipate that similar actors operate with similar objectives and cause similar policy implications in other cultures Yet, I suspect that we need a few more examples to convince the central lending authorities and the international aid agencies of the complementarity of the formal and informal sectors of the credit market

I also wonder what Floro and Yotopoulos can do with their distressing equity conclusion. Should we be concerned about protecting small farmers from aggressive, large farmer-lenders? How great is this problem, and what are the controls on it? Small borrowers in some countries pool their resources and obtain the means to set up their own lending institution. Of course, these small borrowers have the information that allows them to avoid adverse selection of risk when lending to themselves. Do these pooling arrangements give us any insight?[2] Floro and Yotopoulos took us most of the way in good style. Their good book would have been even better if it had closed with their reflections on the equity problem they raise.

## Why Aren't More Economists Rich?

*If You're So Smart. By Donald N. McCloskey. Iowa City: Univ. of Chicago Press, 1990, 190 pages, $17.95.*

***Reviewed by Clifford Dickason***

In this, his most recent book, University of Iowa economics professor Donald McCloskey sets out anew to support his contention that rhetoric is critical to both applied economics and establishing the validity of economic hypotheses. Economists are peculiarly vulnerable to a common American query, "If you're so smart, why aren't you rich?" Most economists are not rich. They are presumed to have achieved a thorough understanding of economic phenomena, especially markets. Yet, the question implies that competent economists would have a steady flow of income, gained from their informed speculating in real estate, commodities, and the stock market.

McCloskey singles out as especially flawed those modernist economists who employ only precise mathematical logic and purely objective data. He believes that they are not sufficiently critical of their own tendency to dismiss what may be best described as the numerous institutional and psychological forces that affect a nation's economy. He is not implying that modernist economists are incompetent. Rather, they fail to divine the results of continual change among institutions, producers, investors, and consumers. Precise mathematical conclusions easily fall victim to the vagaries of institutions and the psychology of human beings. He advises us that lucrative economic predictions are more in the realm of art than science and wisely reminds us that it is futile to pretend that humanity is predictable within the modernists' context of objective data and flawless mathematical logic.

McCloskey demonstrates that the era of modernism, or pure logical positivism, has ended for several sciences, replaced by scientific convention that employs rhetoric. Philosophy, which had experienced a modernist phase, led the way. Physics, astronomy, and other sciences followed. The author persuasively argues that economic hypotheses, even if ostensibly tested by strictly logical analyses of purely objective data, have usually been judged by their proponents' rhetoric and the torrent of opposing discourse and debate before a rhetorical consensus is reached. The debaters have been economists who were familiar with the subject matter.

The author demonstrates that the rhetorical consensus process for judging the realism of economics generalizations usually and justifiably includes a tetrad of basic rhetorical components: objective data, logic, metaphors (that is, models), and storytelling. Storytelling is defined as describing economic phenomena in an eclectic manner, which usually brings together objective facts and constraints based on logic, institutions, conventions, history, and psychological factors. The story narratives usually take the form of extended, multifaceted generalizations based on established economic theory and common features of similar historic occurrences.

McCloskey commends the modernists' fascination with the perfection of abstractions, but to behave and write as though no legitimate research can be done beyond the realm of objective facts and precise mathematical logic is to perpetuate a methodological dogma. Economists can provide more utility to society by including messy realities and "*un*-sterilized" data in their analyses.

An analogy from the phenomenon of falling objects illustrates McCloskey's theories on how modernist economists go wrong. Sir Isaac Newton discovered

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[2]This issue has been debated in the context of Indian agriculture. For a survey, see P.K. Bardhan (ed.), *The Economic Theory of Agrarian Institutions*, Oxford: Oxford University Press, 1989.