Title: Does microcredit increase aspirations and well-being? Evidence from Sierra Leone

Microcredit has received substantial attention because of its promising potential to help achieve the United Nations Sustainable Development Goals (SDGs), in particular poverty alleviation, woman empowerment and decent work opportunities (self-employment). However, its effectiveness has been exclusively evaluated in terms of relieving external constraints of the poor, such as a lack of financial capital for business development. Our study is the first that examines whether and to what extent microcredit can reduce internal psychological constraints. This is important as alleviating internal constraints may turn out to even be more important than reducing external constraints to induce a process of development. We use a self-collected cross-sectional dataset of 1295 women in Sierra Leone, of whom 845 are borrowers of BRAC. BRAC’s eligibility rules enable to conduct unbiased estimates of the impacts of microcredit on aspirations, subjective well-being and economic welfare. Our results reveal statistically significant and economically meaningful positive impacts of microcredit on life aspirations, life satisfaction, monthly education spending and expected income. We find indicative evidence that social interaction and connectedness as well as role models within lending groups are two potential mechanisms through which the effects on life aspirations occur. Overall, this study suggests that microcredit plays an important role in reducing internal psychological constraints. In light of the somewhat disappointing outcomes suggested by several recent randomized controlled trails which mainly focus on the microcredit impacts on external constraints, this research also provides a more positive picture of the potential contribution of microcredit in realizing the SDGs.