REVIEWING THE PROGRESS AND CHARTING THE PATH AHEAD: THE MICROENTERPRISE RESULTS AND ACCOUNTABILITY ACT OF 2004

HEARING

BEFORE THE

SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS AND INTERNATIONAL OPERATIONS

OF THE

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THURSDAY, JULY 27, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS
AND INTERNATIONAL OPERATIONS,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2 o'clock p.m. in room 2200, Rayburn House Office Building, Hon. Christopher H. Smith (Chairman of the Subcommittee) presiding.

Mr. SMITH. Good afternoon to everyone. I would like to welcome Members and our witnesses to this hearing of the Subcommittee on Africa, Global Human Rights and International Operations.

Today we will review a topic which has been of great interest to me and to other Members of this Subcommittee for many years, and that is the issue of microenterprise. While the term "foreign aid" can sometimes assume a rather negative connotation, the tools of microfinance and microenterprise provide a shining counterpoint to some other programs that simply don't perform.

It was not uncommon in the past to see foreign aid delivered in a top-down manner to corrupt governments and organizations where it could never realistically reach its intended recipients. Such programs never delivered the benefits they promised.

Microenterprise, on the other hand, takes advantage of a very different method. It uses a trickle-up approach that focuses on helping the most impoverished people in the world build themselves up little by little into self-sufficiency by providing them with access to financial services like small loans and savings accounts.

The sum of $58 does not seem a great deal of money to most of us in the developed world, but it is precisely the amount that helped change forever the life of Janet Korutaro, a widow from Nsike Village, Uganda.

Opportunity International, represented today by its Senior Vice President, Susy Cheston, who has been a great help over the years in crafting our legislation, provided Janet with a loan in this amount so that she could expand the small grocery store that she runs in her house.

This loan and subsequent loans, of $115 and $171, have allowed Janet to significantly expand her business, adding sugar, salt, eggs, and a refrigerator to hold juice, soda and fruits, along with other improvements. Janet's daily net profit is just $1.15, but this goes very far in Uganda. These three small loans have helped to take a widow in Africa from barely surviving and not daring to dream to believing that all of her dreams might actually come true. Today Janet anticipates being able to educate all of the children in her care, buy land and build a little house.

Similar microloans have benefited over 5.8 million other clients of USAID-assisted microprograms in fiscal year 2005.

The result is clear—microenterprise has the power to dramatically change lives for the better.

Success stories like Janet's are what microfinance and the Microenterprise Results and Accountability Act of 2004, as well as the legislation we did in 2003, Public Law 108–484, are all about. When I offered these pieces of legislation we worked very hard in the House and the Senate and with the Administration and nongovernmental organizations to encourage the best possible microfinance programs, allowing us to reach the greatest number of people with services that truly have an impact on their lives.

The act directs USAID to report to Congress on the status of the agency's microenterprise programs each year at the end of June. I am pleased to have read and reviewed the first such report which covers USAID's activities through 2005. It is a comprehensive, thorough and informative report that will benefit not just the United States Congress but the whole industry. While I am sure that Members will have several questions today concerning the content of the report, I want to congratulate and thank USAID, Ms. Schafer, for a very, very high quality product.

The Microenterprise Results and Accountability Act of 2004 also includes a number of other provisions that we believe will improve the quality of microfinance initiatives around the globe. Among these are provisions that mandate the development of more reliable poverty assessment tools and of systems to measure effectiveness of for-profit contractors and not-for-profit partners. In addition, we included directives on USAID's central funding and on microenterprise programs for people afflicted with HIV/AIDS and for victims of human trafficking.

The final question that we must examine is this: Are these programs focused enough on directly benefiting the poor and other groups who would benefit the most from the tools of microfinance? Our witnesses today, who represent the Administration and the non-profit, consultant, and academic communities, will help to provide us with the answers to these vital questions.

I want to conclude with a story. When I went to Uganda just a few months ago, I visited Mbuya Reach Out, a faith-based organization under the auspices of Our Lady of Africa Church in Mbuya, Kampala. This center, like many others around the world, is using microcredit to transform lives, serving over 1,800 HIV-positive clients and their families. Not only did these individuals get the antiretrovirals that were needed, that were life-sustaining, they also had the hope that my job brings, and my wife and I and other members of our delegation all spent several dollars on the items that were being sold in one of the outlets that was the result of a microfinancing loan.

Income generation and self-reliance are encouraged in Mbuya through Bread for Life, a microfinance program that has provided more than a thousand small loans for small business investment and skills training through the Roses of Mbuya, a tailoring workshop that targets unemployed HIV-infected women.

Is this exactly how all microfinance programs are focused? No. But it does illustrate well the profound impact that American foreign aid can have on real human lives when the tools of microenterprise are put to work. I hope we can continue the discussion of this topic constructively today and I can firmly say that this Subcommittee, and I do believe the Full Committee as well, will remain involved in this very important area.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF THE HONORABLE CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY AND CHAIRMAN, SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS AND INTERNATIONAL OPERATIONS

Good afternoon. I would like to welcome fellow Members, our witnesses, and other visitors to this hearing of the Subcommittee on Africa, Global Human Rights and International Operations. Today we will review a topic of great interest to me and to other Members of this Subcommittee for many years—microfinance.

While the term "foreign aid" can sometimes assume a rather negative connotation, the tools of microfinance and microenterprise provide a shining counterpoint to other programs that just don't perform.

It was not uncommon in the past to see foreign aid delivered in a top-down manner to corrupt governments and organizations, where it could never realistically reach its intended recipients. Such programs never delivered the benefits they promised.

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Success stories like Janet's are what microfinance and the Microenterprise Results and Accountability Act of 2004, PL 108–484, are all about. When I authored that legislation, we worked very hard in the House and the Senate with both the Administration and with non-governmental organizations to encourage the best possible microfinance programs, allowing us to reach the greatest possible number of people with services that truly have an impact on their lives.

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I now yield to my good friend and colleague from New Jersey, the Ranking Member Mr. Payne.

Mr. SMITH. And having said that, I would like to now introduce our very distinguished witnesses. We will begin first with the Honorable Jacqueline Schafer, who is Assistant Administrator of the Bureau for Economic Growth, Agriculture and Trade of the U.S. Agency for International Development since November 2005. Prior to joining USAID, Ms. Schafer served as Director of the Arizona Department of Environmental Quality, as Assistant Secretary of the Navy, and a member of President Ronald Reagan's Council on Environmental Quality. And I would also point out that she has lived in New Jersey, in Haddon Heights, and went to school in Teaneck, New Jersey.

So, my fellow New Jerseyan, welcome and please proceed as you would like.

STATEMENT OF THE HONORABLE JACQUELINE E. SCHAFER, ASSISTANT ADMINISTRATOR, BUREAU FOR ECONOMIC GROWTH, AGRICULTURE AND TRADE, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Ms. SCHAFER. Thank you, Mr. Chairman, and Members of the Subcommittee, for the opportunity to appear before you today to report on USAID's progress in implementing the Microenterprise Results and Accountability Act of 2004. I respectfully request, Mr. Chairman, that my entire written statement be included in the official record of this hearing.

Mr. SMITH. Without objection, so ordered.

Ms. SCHAFER. In fiscal year 2005, USAID obligated $211 million for microenterprise development, which supported 435 institutions in 68 countries throughout the developing world. USAID-assisted microfinance institutions served 5.8 million loan clients as well as 6.4 million savings clients. Enterprise development support reached more than 690,000 clients. In Africa and Asia in particular, institutions serving these clients also implement programs that aim to increase the productivity and profits of smallholder farmers through access to more and better inputs, improved practices, value-added processing, and access to high value markets.

Sixty-one percent of the clients that benefited from USAID microenterprise support were women, like Maria Terese Perez, an entrepreneur I met in Mexico City who has after 2 years of loans from FinComun, a USAID-supported microfinance institution, expanded her business of sewing and selling school uniforms and children's clothing to the local market. Although Mrs. Perez is not among the poorest clients that benefited from USAID microenterprise support, the impact of the loans that she received extends to her nine employees, who now have higher incomes and can invest in their own family's futures by meeting their education and health care needs.

Mr. Chairman, I say that she is not the poorest, but her workroom is maybe 10-by-10, including storage for the cloth, and a third floor walk-up in what we might call a rough part of town. She was cheerful, hopeful and appreciative of the services of FinComun and aware that the United States supported her business in an important way.

The impact of USAID microenterprise programs extends beyond people like Mrs. Perez, her family, her employees, and her customers to Mexico's entire financial sector, which is undergoing a long-term structural change, integrating poor households and enterprises into the vision, business model and product range of the country's major financial institutions.

I would like to update you and the Committee, Mr. Chairman, on the status of activities required by the most recent amendments to the statute, including new grant programs, increased assistance to USAID's field missions that implement microenterprise programs, and improvements in our data collection system.

First, the FIELD-Support Leader's with Associates cooperative agreement, LWA, was competitively awarded in 2005 to a team of highly qualified organizations led by the Academy for Educational Development. This team, comprising 10 core members and 17 resource organizations, has a proven track record of reducing poverty and promoting sustained, equitable growth through microenterprise development, microfinance, value chain development, institution and human capacity building, and the promotion of market-based approaches. This year's tranche of leader funding from my bureau's Microenterprise Development Office is supporting initial activities worldwide that will focus on testing new approaches and sharing knowledge widely within the practitioner community about remittances, natural resources management affecting agricultural productivity, health services and mapping the social performance of microfinance institutions. I am told that, while still procurement sensitive, in fiscal year 2006 associate awards from our missions will encumber nearly 20 percent of the $350 million ceiling for this 5-year procurement instrument. So we are off to a good start.

The Agency will also award grants this year totaling up to $10 million through the Implementation Grants Program. These grants will go to institutions working to increase access to financial services for very poor clients and to link very poor people into markets. In addition, awards under the Grants Under Contract mechanism totaling almost $3 million will be made to three different types of institutions. The first are institutions working to increase their capacity to learn from their activities and share that knowledge with the broader industry. The second are institutions working to fund innovative ways to serve poor and very poor clients in Europe and Eurasia, and third are institutions using information technology to broaden their outreach and reduce transaction costs.

USAID also has increased its technical support to missions in 2005. Our bureau's microenterprise technical officers helped regional bureaus and missions to conduct thorough reviews of proposed strategies and activities, and they have been proactive in supporting missions that are developing new strategy elements and components. For example, extensive technical assistance to USAID Afghanistan has supported a major new rural finance program that will extend credit savings and other financial services and support to tens of thousands of smallholder producers and rural families that have extremely limited access to finance.

In this past year our staff has provided on-site assistance to about 25 other missions, including Sudan, Liberia, Uganda, Tanzania and South Africa, and extensive virtual technical support in both strategy and activity design for others, including Iraq.

In fiscal year 2005, USAID instituted changes to our Microenterprise Results Reporting system to, among other things, identify the portion of obligated funds that are sub-obligated by the original recipient to other awardees, and thus improve our understanding of who the ultimate recipients of the funding are. We found, however, that the direct recipients considerably understated the amounts that will benefit local organizations. So we have revised the data collection process for 2006 to capture more accurately the portion of funding that is intended for eventual sub-obligation even when the sub-obligation is not completed during the fiscal year in which the initial award was made. There is some time lag. We expect this change to yield more accurate details of USAID microenterprise funding by institution type.

With regard to development of the poverty measurement tools mandated by the Microenterprise for Self-Reliance Act of 2000, a rigorous effort involving methodologists, academic advertisers and practitioners has led to the completion of the development, testing and certification of two new tools that can be implemented by partners beginning in October 2006. While USAID and its partners had hoped that these two tools that have been developed and certified for use at the regional or international level would predict client poverty status with acceptable accuracy, this has not proven to be the case. The testing process has yielded results that indicate that tools tailored to specific country, and even sub-national, characteristics would achieve significantly better accuracy. Practitioner organizations selected on a competitive basis have received funding to field-test country-level tools to ensure that these instruments meet the law's practicality standard; that is, that the diverse range of practitioners with which USAID works can comply at a reasonable cost.

By October 1, 2006, country specific tools will be available or in development for many countries, including some of those with the largest microenterprise development programs. USAID will continue to work in partnership with researchers and practitioner communities to develop and/or certify country specific tools for other countries in which USAID operates microenterprise programs.

Mr. Chairman, allow me to touch briefly on the umbrella study that we referenced in our 2005 report. Generally it found that the ability of umbrella programs to work with a range of institutions on a variety of interventions at multiple levels of the financial system results in a more sustainable financial system in which poor people are more likely to enjoy the benefits of economic growth. Moreover, the study found that the nature of the program that is umbrella versus single institution was not a factor in determining either cost effectiveness or the sustainability of the institutions themselves.

Mr. Chairman, that concludes my oral statement and I appreciate again the opportunity to present our program.

[The prepared statement of Ms. Schafer follows:]

PREPARED STATEMENT OF THE HONORABLE JACQUELINE E. SCHAFER, ASSISTANT ADMINISTRATOR, BUREAU FOR ECONOMIC GROWTH, AGRICULTURE AND TRADE, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to appear before you today to report on USAID's progress in implementing the Microenterprise Results and Accountability Act of 2004, since your September 20, 2005 hearing.

Generating economic growth in developing countries while reducing poverty is a fundamental development challenge. It is also critical to national strategic and security interests, as reflected in the growing role USAID is being asked to play in rebuilding, developing, transforming and sustaining partnership countries.

Only a few weeks ago here in Washington, President Bush addressed the private-sector Initiative for Global Development saying that "the reduction of extreme poverty in our world must be a key objective of American foreign policy." And, the President added, the effort to eliminate global poverty "needs to be part of the calling of the United States in the 21st century." The President also emphasized that he expected principles of transparency, performance and accountability to be applied to all our development aid, saying, "We're going to be generous in our contribution and demand results in return." So, Mr. Chairman, our assistance programs are being held to account by both the Congress and the Chief Executive.

USAID's vision for microenterprise development is to strengthen economic opportunities for poorer households and the business activities on which they typically rely to enable these families to build assets, cope with the risks and vulnerability that accompany poverty, and plan for better futures for their children. These strategies support delivery of effective financial and business services that poorer families and entrepreneurs need to succeed in these challenges, as well as policy changes that reward initiative and hard work. USAID's partnerships with hundreds of diverse U.S. and local microenterprise practitioners have also demonstrated that microfinance and microenterprise development services can contribute to poverty alleviation in a sustainable and commercially viable way.

In September's hearing, the Agency presented the status of our efforts to implement the law in the context of these overall strategies and programs. Today, I will present the Agency's response to the twelve reporting requirements in the Microenterprise Results and Accountability Act of 2004, as well as our implementation of key activities that we know to be of special interest to the committee.

RESULTS

Funding, client results and program examples

In Fiscal Year (FY) 2005, USAID obligated $211 million for microenterprise development, supporting 435 institutions (218 of which had new agreements this fiscal year) in 68 countries throughout Africa, Asia and the Near East, Latin America and the Caribbean, and Europe and Eurasia. Nearly $22 million of this support came from central programs.

USAID's microfinance support has helped strengthen financial sectors to better meet the needs of poor households and new and growing microenterprises. Microfinance institutions (MFIs) and other financial institutions that received USAID microenterprise assistance in FY 2005 served 5.8 million loan clients, as well as 6.4 million savings clients. Sixty-one percent of these clients were women.

What does USAID support mean for these clients? In Mexico City, I met Maria Terese Perez, a businesswoman who makes her living sewing and selling school uniforms. In her two years as a client of FinComun, a USAID-supported microfinance institution, Ms. Perez was able to expand her business to nine employees, buying material more cheaply in the low season with a loan from FinComun, and sewing enough uniforms to have on hand when the high season hits. A new type of loan from FinComun will enable her to buy a machine that can embroider cloth, so she can expand into higher-value fashions.

Ms. Perez and her employees, who now have higher incomes, can invest in their families' futures by meeting their education and health care needs. But the impact extends beyond Ms. Perez, her family, her employees and her customers, to Mexico's financial sector, which is undergoing a long-term, structural change geared toward integrating poor households and microenterprises into the vision, business model and product range of the country's major financial institutions. This means that millions of Mexicans like Ms. Perez can count on the sustained access to the financial services they need to cushion against financial shocks, meet their families' needs, build their businesses and other assets and invest in the future of their communities and their nation.

Some of the institutions USAID supported in FY 2005 were able to gain access to and increase their loan capital through the use of USAID's partial credit guarantees. USAID's partial credit guarantees of $6.361 million leveraged $224 million in private sector credit for institutions serving microfinance clients.

There are many impressive examples. USAID and Deutsche Bank launched the Global Commercial Microfinance Consortium in November 2005 in an effort to empower low-income households and small enterprises through increased availability of financial services. Spearheaded by Deutsche Bank, the $75 million program aims to channel financing from conventional and social investors into high-performing microfinance institutions around the world, so they can scale up their offerings of diverse financial services to low-income households and small enterprises. The USAID guarantee (put together through a team effort between EGAT's Development Credit and Microenterprise offices and the Global Development Alliance Secretariat) helped bring private commercial investors to the table. In its first full quarter of activity, the Consortium has approved and disbursed eight loans to microfinance institutions (totaling $13 million). Eleven new approvals are pending (totaling $24.4 million), and the value of deals under discussion exceeds remaining funds.

USAID also leverages outside funding through matching requirements. The Agency frequently requires that its funds for a particular purpose be matched by financing from other sources, including the recipient institution itself. In FY 2005, $27.6 million in USAID funds generated an additional $9.2 million from other sources. Sources of matching funds can encompass private donations, multilateral funding, commercial and concessional borrowing, savings and program income.

More than 690,000 clients received enterprise support services through USAID-funded institutions. In Africa and Asia in particular, these institutions implement programs that aim to increase the productivity and profits of smallholder farmers through access to more and better inputs, improved practices, value-added processing, and access to higher-value markets.

An example of this work can be found in the USAID-supported KenyaBDS (Kenya Business Development Services) project. This project focused on helping Kenya avocado producers enter the seasonal avocado market during the time of year when producers in South Africa and elsewhere do not meet demand. While KenyaBDS was able to identify a market in the United Kingdom with growth potential, the value chain for avocados in Kenya was unorganized, and farmers needed to upgrade their operations to improve the quality of their produce and provide exporters with a consistent supply of exportable avocados.

One of KenyaBDS's most significant accomplishments was to help farmers organize into producer groups, and link them, as groups, to exporters. Initially, there was little trust on either side: Exporters doubted whether farmers could deliver the quality and quantity they needed to meet the demands of the UK market, and farmers were not sure that exporters would be trustworthy buyers and give them a fair price for their upgraded product.

Ultimately, though, KenyaBDS's experiment paid off. As farmers learned about the power of organizing, upgrading and delivering on time, exporters learned that small suppliers could provide the quality they needed and the quantity they were unable to access without these small suppliers. As the success of KenyaBDS's pilot spread, more and more exporters sought to partner with small avocado farmers. Most recently, these Kenyan exporters have been able to gain access to supermarkets in London—a clear indication that KenyaBDS's strategy has benefited both exporters and small farmers.

USAID also worked in FY 2005 to assist members of particularly vulnerable groups. Fifteen missions with microenterprise programs reported a relationship between poverty and race/ethnicity in their countries.[1] Clients benefiting from microenterprise funding in these countries constitute a significant share of all clients benefiting from USAID microenterprise funding: they are 38 percent of all loan clients, 44 percent of all savings clients, and 10 percent of all enterprise development clients.

Moreover, $15 million of USAID's microenterprise funding in FY 2005 assisted victims of trafficking in persons and women who are particularly vulnerable to other forms of exploitation and violence.

Poverty measurement tools

The Microenterprise for Self-Reliance Act of 2000, as amended, mandated that half of all USAID microenterprise funds benefit "very poor people", defined as those living on less than $1 a day (adjusted for purchasing power parity), or those in the bottom 50 percent of people below their country's poverty line. The lack of widely applicable, low-cost tools for poverty assessment had made it difficult for USAID to determine whether it was meeting these mandated targets. Therefore, the 2000 Act also required USAID to develop and certify at least two tools for assessing the poverty level of its microenterprise clients.

In FY 2005, USAID completed work on the development of two new tools to measure the poverty status of clients of USAID-assisted microenterprise institutions and better gauge our service to them. We are also collaborating with our partners to develop country-specific tools that may achieve greater accuracy.

The Microenterprise for Self-Reliance Act initially set October 2005 as the deadline for USAID-assisted microenterprise institutions to begin implementing the tools; subsequently, the Microenterprise Results and Accountability Act of 2004 extended that deadline to October 1, 2006. A rigorous effort involving methodologists, academic advisors and practitioners has led to the completion of the development, testing and certification of two tools that can be implemented by partners beginning October 1, 2006. While USAID and its partners had hoped that these two tools that have been developed and certified for use at a regional or international level would predict client poverty status with acceptable accuracy, this has not proven to be the case. The testing process stipulated in the Act has yielded results that indicate that tools tailored to specific country (and even sub-national) characteristics will achieve significantly better accuracy. Practitioner organizations selected on a competitive basis have received funding to field-test country-level tools to ensure that these instruments meet the law's practicality standard, i.e., that the diverse range of practitioners with which USAID works can comply at reasonable cost.

By October 1, 2006, country-specific tools will be available or in development for many countries, including some of those with the largest microenterprise development programs. USAID will continue to work in partnership with researchers and the practitioner community to develop and/or certify country-specific tools for other countries in which USAID operates microenterprise programs. More complete information about the process of developing, testing and certifying the tools can be found online at www.povertytools.org.

Performance goals and indicators

USAID also established and measured quantifiable performance goals and indicators in FY 2005. These appear in Table 1, appended to this statement.

On a worldwide basis, USAID and its implementing partners substantially met or exceeded all targets except that for the percent of funds benefiting the very poor (for which results are inconclusive). Performance was particularly strong in the number of clients served (44 percent above the target of 4.5 million) and financial strength of microfinance implementing partners.

USAID can state with confidence that, in FY 2005, 37 percent of financial services funding, and 18 percent of enterprise development funding, benefited the very poor.

[1] The countries are Mali, South Africa, Sudan, Nepal, Tibet, Albania, Serbia, Bolivia, Brazil, Colombia, Ecuador, Guatemala, Mexico, Panama and Peru.

USAID assumes that a significantly larger share of microenterprise funding benefited very poor clients but cannot validate that assumption due to the poor fit between the mandated poverty loan proxy and the services that enterprise development institutions deliver to their clients.

FY 2005 is the last year for which the regionally-adjusted loan size proxy serves as the yardstick for measuring the extent of service to very poor clients. Beginning with the FY 2006 MRR report, progress toward targets will be determined through use of improved client poverty assessment tools currently under development by USAID. The loan size proxy has proven increasingly problematic in estimating service to very poor microenterprise and microfinance clients. Many microfinance clients are gaining access to financial services other than loans, such as savings, insurance and affordable remittance services, limiting the relevance and utility of a metric based solely on loans. For those benefiting from diverse enterprise support—access to better markets, improved technologies—the loan size proxy is clearly not relevant, which contributes to the low enterprise development percentages shown in Table 1. As the share of funding for enterprise development activities has grown, this bias has in turn lowered the overall estimate of funds benefiting very poor clients, a trend noted over the past several years.

Another factor that affects the estimate of the extent to which USAID and its partners serve very poor clients is the geographic composition of microenterprise funding worldwide. The share of the population that meets the statutory definition is very small in some countries that have large microenterprise development obligation levels, such as Ukraine.

With the phase-in of the poverty measurement tools, USAID expects to have a better basis on which to determine the extent of service it provides to very poor clients for the full range of microenterprise development activities. This in turn will provide a better basis for identifying opportunities to prescribe specific actions to improve performance.

USAID is already taking steps to increase the extent of service to very poor clients. For example, the MD office has focused its competitive grant programs specifically on identifying and supporting program models that promise to improve both the extent of service and the impact of that service on very poor microfinance and microenterprise clients. Intra-agency working groups are identifying, testing and disseminating interventions that work for specific client segments that have a higher incidence of poverty, such as youth, refugees and internally displaced persons, and residents of conflict-affected zones, remote rural communities, and areas with high HIV–AIDS incidence.

RELATIONSHIPS WITH MISSIONS AND PARTNERS

USAID continued to provide program guidance to field missions in FY 2005, extending the impact of support through ensuring mission access to expert technical assistance in microenterprise development. The Microenterprise Development office continued its intensive work with field missions on designing, implementing and assessing programs that apply the knowledge of how best to serve the very poor that is emerging from this focused experimentation and applied research. Through collaboration, USAID's technical experts in microenterprise development can help missions apply best practices to their microenterprise programming. For example, extensive technical assistance to the Afghanistan mission resulted in a major new rural finance program that will extend credit, savings, and other financial services and support to tens of thousands of smallholder producers and rural families that have extremely little access to finance and are likely to be poorer than those benefiting from other USAID programs on the ground.

To comply with the new statutory requirement that the Microenterprise Development office concur in strategies of USAID missions and bureaus that include microenterprise and microfinance components, MD staff has engaged with regional bureaus and missions to conduct thorough reviews of proposed strategies and activities. MD staff has been proactive as well in meeting the related provision in the law, i.e., that the office provide support and technical assistance to missions in developing new strategy elements and components. In the past year, for example, the MD staff has provided on-site assistance to missions including Afghanistan, Pakistan, Indonesia, Mexico, Haiti, Brazil, Albania, the Central Asian Republics, Azerbaijan, Serbia, Morocco, Egypt, Jordan, India, Sri Lanka, Sudan, Liberia, Uganda, Tanzania and South Africa. The staff has also provided extensive virtual technical support in both strategy and activity design for diverse missions, including Iraq.

Also, in June 2006, USAID held its first learning conference on microenterprise development. We convened more than 300 partners and other practitioners in the microenterprise field in order to alert them to changes in the U.S. Government approach to foreign assistance, engage them on the key strategic questions currently facing the microenterprise development field, and enable all of our grantees and contractors to learn from each other about the USAID-supported work they're doing, the discoveries they are making, and the successes they need to be replicating.

NEW FUNDING MECHANISMS

We continue to work closely with our partners through our new funding mechanisms as well: through our Leader With Associates mechanism, which links a diverse consortium of partners directly with USAID missions; and through other grant programs, such as the Implementation Grant Program (IGP) and our Grants Under Contract mechanism.

Financial Integration, Economic Leveraging, Broad-Based Dissemination (FIELD-Support) Leader with Associates

The Agency has begun implementing a new microenterprise FIELD Support Leader with Associates (LWA) mechanism. This LWA has been designed to mobilize the expertise of the nonprofit community and strengthen their relationships with, and relevance to, USAID missions. FIELD-Support will operate through FY 2010, with a possible five-year extension through 2015.

The LWA is designed to implement innovative, comprehensive, and integrated approaches to sustainable economic growth with poverty reduction. This includes building more inclusive financial systems, improving the competitiveness of industries in which micro and small enterprises participate, and enhancing the overall policy and regulatory environment to enable broad-based economic growth. FIELD-Support is also designed to respond to the economic security needs of special populations, such as families hurt by civil conflict and natural disaster, and communities hit hard by HIV/AIDS and other health issues; as well as address the livelihood and enterprise needs of difficult-to-reach clientele such as the poor in remote rural areas, youth, women, refugees, and internally displaced persons.

The FIELD-Support LWA was competitively awarded by USAID's Microenterprise Development office to a team of 27 highly qualified organizations, led by the Academy for Educational Development (AED). The team, comprising 10 core members and 17 resource organizations has a proven track record in reducing poverty and promoting sustained, equitable growth through microenterprise development, microfinance, value chain development, institution and human capacity-building, and the promotion of other market-based approaches. Experiences include supporting micro and small enterprises' access to market opportunities, strengthening and deepening financial systems, promoting sustainable livelihoods and improving the national and local enabling environment. Sustainable livelihood work increases poor household assets and strengthens their coping strategies, while enabling environment work focuses on both the national and local levels to boost productivity, earnings, and competitiveness.

The LWA—which has an overall ceiling of $350 million over five years—is off to a strong start, with initial Mission associate awards in the pipeline. By the end of this fiscal year, the Microenterprise Development office expects to obligate a cumulative total of $2 million for the base "leader" agreement to implement pilot projects that address these objectives throughout the world. In addition, USAID missions are showing great interest in utilizing the FIELD Support LWA to address regional needs. By the end of FY 2006, USAID expects missions to enter into "associate" cooperative agreements totaling approximately $60 million, nearly 20 percent of this mechanism's ceiling.

USAID Missions and USAID/W offices and operating units are able use the LWA over a five-year period. The LWA provides a streamlined procurement mechanism for missions to partner with NGOs and PVOs to meet growth and poverty alleviation goals, as an attractive alternative to working with contracts and for-profit firms. Design and implementation of the LWA is one of a number of steps USAID has taken to ensure that it has access to the best possible combination of partners with which to implement its microenterprise programs.

Implementation Grant Program (IGP)

The FY 2006 Implementation Grant Program will include awards to both financial services and enterprise development institutions. The Financial Services grant round, focused on "Access to Financial Services for the Very Poor," attracted fewer responses than anticipated, but assessments of those that are the top contenders indicate strong programs involving a range of financial institutions (banks, NGOs, multi-sectoral programs and specialized microfinance institutions) working to integrate a variety of clients into the financial system (including youth and rural and agricultural producers as well as traditional clients who are poor or very poor).

The Enterprise Development grant round, "Linking Economic Growth to Poor Households," focuses on approaches that foster the competitiveness of industries in which large numbers of very small firms participate, by improving microentrepreneurs' access to the finance, business services and knowledge they need to compete in growing markets, while ensuring that the poor who operate these very small firms benefit from participating in growing markets.

Awardees will collaborate through a learning network with a structured learning agenda to share with each other and the larger industry those strategies, products and services that show promise in reaching and retaining very poor clients.

The combined funding for these worldwide grant competitions is $10 million. Awards will be made by the end of the fiscal year.

Grants Under Contract (GUC)

The Agency also continues to implement its grants under contracts program, which provides targeted grants to key implementing partner organizations. These grants are used to help institutions address key implementation and institution building issues which would normally not be funded by donor programs. The program emphasizes joint learning and the sharing of results, so that the impact of these grants can be leveraged across a broader swath of implementing partners, rather than accruing just to the benefit of the grantee. The total value of this program is $2.86 million.

In 2005, the Agency, in collaboration with a number of implementing partners, determined an industry-wide need for institutional support to develop or reinforce learning and knowledge management capacity. Institutions had repeatedly requested that USAID provide assistance to institutionalize frameworks that will help them to learn from current operations and apply the knowledge they gain to benefit future programs. In December, the Agency made six awards totaling $650,000 to increase recipient institutions' capacity to learn from their activities, apply their learning in order to adapt their activities and generate new ideas, and share their new knowledge with the broader industry.

In early 2006, the Europe and Eurasia Bureau identified the need to develop approaches to increase the incomes of historically marginalized populations by improving or creating access to markets and financial services. In late spring, the Agency released a request for grant applications for programs supporting these hard-to-serve populations. These programs will develop channels to integrate the targeted populations into the broader economy, and to build a knowledge base of successful tools for integrating poor people into the markets and financial systems from which they have been excluded. The Agency expects at least some of the applicants to be non-traditional partners, including youth-serving organizations or health programs. Grant applications have just been received with about half coming from international PVOs and half coming from local NGOs. Only proposals for integrating these populations permanently into markets will be selected for awards totaling $500,000. Recipients will be required to collaborate through a "learning network" to share the knowledge they gain reaching hard to reach populations. Proposals have been received; awards will be made by the end of fiscal year 2006.

In the remainder of FY 2006, the Agency will release two more requests for grant applications, with one targeted to rural and agricultural populations (this may be combined with an information technology focus), and one to test the cost-effectiveness of newly developed poverty assessment tools.

Sub-obligations, cost-effectiveness, sustainability

In FY 2005, the amount of funds obligated directly to all non-profits was approximately 37 percent of total microenterprise support, which included funds to U.S.-based PVOs (16 percent), local NGOs (16 percent), cooperatives (2 percent), credit unions (2 percent) and research and educational institutions (1 percent). The amount obligated to consulting firms was 51 percent of total funds, an increase from 38 percent in FY 2004.

USAID is working to supplement data on direct obligations with better data on the (often substantial) portions of funding that are sub-obligated, usually from consulting firms to non-profits. Sub-obligations are a key aspect of large "umbrella programs," which are sometimes used by missions to accomplish a range of activities without adding to their management burden. Missions often use umbrella programs in countries where local capacity is limited, and comprehensive, multi-level interventions are required for program success. In these programs, a single awardee (either a consulting firm or a PVO/NGO) carries out a broad range of activities to boost economic opportunities for microenterprises or expand financial services for the poor. While managed by a lead implementer or "prime" recipient single entity, the umbrella program in most cases is carried out by a consortium of partners that bring distinct expertise, given the breadth of skills required by the program, and that receive a portion of the funds obligated to the "prime" through sub-contracts or sub-grants. Microfinance umbrella projects generally aim to reduce dependence on donor funding and subsidized technical assistance by addressing the market-level constraints to mainstreaming microfinance for the poor. These constraints often take the form of lack of services on which microfinance institutions rely. Umbrellas address these constraints by building locally available supporting services, and strengthening the policy, regulatory, or legal framework for microfinance.

In FY 2005, the Agency completed a study on umbrella mechanisms in an effort to better understand the use of these agreements by USAID missions, their relative cost-effectiveness and that of other mechanisms, and their role in USAID's microenterprise development support. Many of this study's findings apply to umbrellas but also more broadly to other agreements with for-profit and non-profit partners. This study was recently reviewed by the advisory group, comprised of non-profit and for-profit practitioners, other donors, and researchers; release to the general public expected this summer.

The study's findings indicate that USAID-funded microfinance programs have been implemented successfully as both umbrella projects and as single-purpose projects by both for-profits and not-for-profits. Detailed analysis of the cost structures of not-for-profits and for-profits offers no evidence that these programs have been implemented inefficiently. Likewise, there is little evidence that either for-profits or not-for-profits are more cost-effective in achieving project results. This study found that it is extremely difficult to directly compare cost-effectiveness between organizations and projects across countries, and virtually impossible to draw broad, general conclusions about relative cost-effectiveness.

Recent refinements to USAID's microenterprise data collection and reporting system allow umbrella institutions to include more details on the various forms of assistance that may be transferred to local organizations via the umbrella institution. Analysis of the database of microfinance umbrellas compiled for the study indicates that since 1997, nearly 47 percent of total funding for microfinance umbrellas was sub-obligated; most of these sub-obligations go to not-for-profits and their local affiliates. In addition, although for-profits served as primes for the majority of the umbrella programs, not-for-profits and their affiliates received much of the in-kind technical assistance and training, as well as funding, associated with these programs.

Sub-obligations, usually made by a for-profit managing a program to non-profits in the form of subcontracts and sub-grants, are often a central component of microenterprise umbrella programs. Additional detail on the subcontracts and sub-grants will eventually aid in providing a more comprehensive picture of the allocation of USAID funds. For FY 2005, the majority of umbrella awardees with agreements signed late in the fiscal year showed much of their funding still in hand at the time of reporting. Most of these funds will eventually be channeled to local organizations, but are not reflected in the data captured for FY 2005.

To enhance our understanding of the portion of funds that get sub-obligated, and who the ultimate recipients of funding are, USAID in FY 2005 requested additional information on the amounts allocated to local institutions through umbrella agreements, apexes or other types of wholesale institutions. The amount of detail provided by the direct recipients considerably understates the amounts that will benefit local organizations. The data on funding flows between for-profits (primarily consulting firms) and non-profits (primarily PVOs and NGOs) is also likely to be incomplete. This is the first year for which USAID has attempted to collect data on sub-obligations for technical assistance as well as direct obligations. The data collection exercise and analysis proved far more difficult than anticipated. Reasons that the data is incomplete are many, and are explained in the Annual Report to Congress. USAID has adapted the data collection process for FY 2006 to capture more accurately the portion of funding that is intended for eventual sub-obligation even if the sub-obligation is not completed during the fiscal year. We expect this change to yield more accurate data on the breakdown of USAID microenterprise funding by institution type.

The microfinance umbrella study also addressed the issue of sustainability. The study found that, for umbrella and other USAID programs, the instrument is not a factor in determining sustainability. USAID uses contracts to procure goods or services to implement its own program, and cooperative agreements or grants to support or stimulate the recipient's program. The sustainability of the program is the result of sound analysis that ensures that benefits continue well beyond program subsidies. Umbrella programs are usually implemented under contracts rather than grants, as USAID perceives the need to exercise greater control over these large and complicated public investments. USAID staff have more control over the direction of programs implemented under a contract.

The amount of USAID support specifically for microfinance that flowed through umbrella agreements between FY 1997 and FY 2005 was less then 30 percent of new USAID obligations for microfinance, indicating that most USAID support for microfinance is still distributed through single-purpose programs, which are generally grants directly to not-for-profits. The share of microfinance funding programmed through umbrella programs during this period seems to have peaked at 37 percent of total USAID funding for microfinance in FY 2002, while just 10 percent of FY 2005 funding was obligated through umbrella programs.

Finally, the study also addressed the issue of sustainability. It found that, for the cases studied (which included institutions assisted through umbrella programs as well as those assisted through single-institution programs), nearly all of the institutions assisted experienced increased financial sustainability and growth. The form of assistance program—whether an umbrella program or a single-institution program—did not influence the sustainability of the institution(s) involved in the program. However, the form of assistance program did influence the sustainability of the broader financial sector. That is, the study found that programs focused at the level of a single institution cannot be as effective as umbrella programs at creating a financial system that permits greater and more sustainable access to financial services. Ultimately, the ability of umbrella programs to work with a range of institutions on a variety of interventions at multiple levels of the financial system results in a more sustainable financial system in which poor people are more likely to enjoy the benefits of economic growth.

Thank you Mr. Chairman. I would be happy to answer any questions you may have.

APPENDIX 1:

Table 1. Performance Goals and Results, FY 2005

Microfinance	**Total Loan Clients #**	**Women Clients %**	**Rural Clients %**	**Funds Benefiting Very Poor Clients %**	**Financially Sustainable MFIs %**
FY 05 goal	3.8 million	60	40	50	50
FY 05 actual	5.8 million	61	45	37	58
Enterprise Development					
FY 05 goal	700,000	30	80	50	
FY 05 actual	694,649	29	95	18	
All clients					
FY 05 goal	4.5 million			50	
FY 05 actual	6.5 million			23	

The count for microfinance clients is restricted to loan clients, as adding in clients for other financial services (savings, insurance, and remittances) may result in double counting.

Mr. SMITH. Thank you so very much for that testimony. Mr. Tancredo?

Mr. TANCREDO. No. I have nothing.

Mr. SMITH. Thank you. I will ask a couple of opening questions. You just mentioned a moment ago how the tools tailored to a specific country or even sub-national characteristics will achieve significantly better accuracy than tools certified for regional and international use. You said that by October 1st many of these will be available. Can you give us any sense of how many countries will be ready by the October 1st deadline and how many will be a work in progress at that point?

Ms. SCHAFER. I don't have the exact number of—I don't think we really know yet the exact number of countries, but it will represent a good portion of our microenterprise development program worldwide. So I think we will be able to get a good indicator of whether these are in fact as we expect that they will be.

Mr. SMITH. You noted in your testimony that there was little evidence that either for-profits or not-for-profits are more cost effective. In evaluating who gets Federal funding, is that a surprise? Is that something that you didn't expect to be the case, and how will that be factored into further distribution of funding?

Ms. SCHAFER. There is so much variability in the nature of the programs on a local basis that I guess it is not too surprising that the ability to compare program to program is difficult but this study, you know, made an effort to look at it in a variety of ways and found that this cost effectiveness issue, most programs try to be cost effective regardless of how they are designed but they are of quite great diversity in the nature of the programs on the ground, and that not one nor the other type of activity or type of approach proved to be more cost effective than the other.

Mr. SMITH. Let me say that we deeply appreciate your leadership, but I have concerns about the vacant Director position in the Office of Microenterprise Development. Is that person to be named soon?

Ms. SCHAFER. That position isn't quite vacant yet. That person who has led this office for I think 8 years now is with us until the middle of next month, and then I will be looking at what we might do. We certainly will have somebody in the office working in the interim and then we would conduct a search or make some arrangement to find a successor. Meanwhile, we have a very fine staff that is doing this work on the ground with our partners in missions around the world, and I expect that work will continue at its pace without any hitch or delay.

Mr. SMITH. So you see a seamless transition?

Ms. SCHAFER. Yes, I do.

Mr. SMITH. That is good. Because so often, and this is regardless of the Administration, when somebody leaves and they have done a good job, sometimes months, even years pass before we get somebody back in. So hopefully that won't be the case.

Ms. SCHAFER. We will find an interim leader if that is necessary in order to make sure that we don't lose the momentum that I think we have gained in implementing these programs over the past few years.

Mr. SMITH. Do you know if the search is already on for that Director?

Ms. SCHAFER. No. It is not yet.

Mr. SMITH. Just to encourage you.

You note that there are over 5.8 million loan clients and 6.4 million savings clients. Is it your sense that clients in the developing world benefit more from saving services or from microloans, or is there a balance there?

Ms. SCHAFER. We are finding that many people who require financial services who are very poor actually value having a savings instrument that they can rely on and others will borrow money. Some will do both. What we want to have is a variety of services that are available and tailored to what the actual demands are by people who need these very small loans. Some people are just reluctant to borrow money at a point in time and other people will borrow money from more than one financial institution. So it really depends on what the demands are for the individual. We are trying to make services available to the whole spectrum of people.

Mr. SMITH. When we had our last hearing on this subject on September 20, 2005, Acting Administrator James Smith testified, and this is something for which Congress, I think, is to be blamed, perhaps Administrations past and present, as well, that USAID technical staff—and I know that Administrator Natsios has complained about this, as does our current Administrator, Ambassador Tobias—that as we cut technical staff at USAID it becomes harder and harder for you and your counterparts at other USAID-assisted programs to do their work. Mr. Smith said that they were down to about 200 officers in the field at that time.

Has anything changed? Are we doing anything to try to build up that technical capability, or is that still a problem?

Ms. SCHAFER. USAID was able to bring in two classes of new entry professionals which have technical expertise in a whole variety of technical subject areas, including finance. So we are trying to rebuild our foreign service capability. We are also able to use non-operating expense instruments to bring in technical expertise and we have a considerable number of those in my own office.

We could never run the program just on our own staff basis alone. That is why we have implementing partners throughout the world. The program is large and the demand is very great.

What I tried to do is make sure that we have the right mix of technical people who can give the value of their expertise to our missions that have microenterprise development programs. An example of a skill set that we have been trying to recruit for is in the remittances area where we know that there are a lot of opportunities for investments in host countries by people who have sent remittances home that will advance the development of that country. And having someone with good knowledge in that area is one of the things that we are trying to recruit for.

So my goal is to have a skills mix that actually is needed for the program so that we can provide the technical leadership for the missions and work with our partners to actually get the impact throughout the world.

Mr. SMITH. That is a tremendous goal. Have you been able to achieve that?

Ms. SCHAFER. As I said, we have got a pretty strong staff in our Microenterprise Development Office. Now we are always trying to make sure that we get the right mix, and I was giving an example of one that we are trying to recruit for now.

Mr. SMITH. If there are ways that we could be helpful, either our Committee or, you know, Congressman Frank Wolf is a close personal friend and obviously the foreign aid appropriations cycle and State Department cycle is something that we discuss often. If there are specific requests that you think would enhance the program, don't be a stranger. Please let us know because we can work to achieve that. We have done that on a number of instances, most recently with the Trafficking in Persons Office. There was a need for more personnel, and we went and worked with Mr. Wolf in this case, and we were able to beef up the number of people for next year. So let us know if there is a need and it has gone unmet.

Let me ask you two final questions. You stated in your testimony that the financial services grant round of the Implementation Grant Program attracted fewer responses than anticipated. I wonder if you can elaborate as to why that is the case, and is it your view that focusing on the very poor limited potential responses from agencies which might have otherwise implemented successful programs?

Ms. SCHAFER. I am not sure that it rose to the occasion or rises to the occasion of being concerned that we don't have good candidates because we do. Our staffs are in the final rounds of looking at the various projects and programs that are competing for that money. So I think we are going to have a good strong award in that area. But the idea that—the difficulty in reaching the poor is not something that everyone feels like they are ready to be able to tackle that technical problem. But the proposals that we do have to tackle that technical problem are strong ones, and we think we are going to have a good outcome from that competition.

Mr. SMITH. You describe in your testimony the problem of accounting for sub-grants and sub-obligations and umbrella programs administered by USAID. Why is it that grant and contract lenders were not previously required to report to USAID regarding their sub-grants and subcontracts? Will more detailed information on such sub-obligations be provided to the Congress in subsequent USAID reports on microenterprise?

Ms. SCHAFER. We began to require that last year. And we posed the question. The information that we got as a result when we actually looked carefully at it appeared to us to seriously underreport the sub-contracting. Partly we often do not make our awards until very late in the fiscal year, but we started collecting the data at the beginning of the following fiscal year. The subcontracts often are not made until several months, if not longer, into the overall contract period.

So there is a lag in getting the information to catch up to be able to report it to you in the time frame that you requested. Sub-obligations have grown in importance in recent years, and that is why we are now trying to require them in the report, and we think that in fiscal year 2006 we are giving them some better tools to make that report and we should have better information so you know who was ultimately getting the benefit of those funds.

Mr. SMITH. As you know, Ambassador Tobias serves as both head of USAID and as Deputy Secretary of State for Foreign Assistance. Do you see any positive impact coming from that very strategic dual position that he holds?

Ms. SCHAFER. The Ambassador has really, as a Director of Foreign Assistance, really taken personal control of the reins for developing a transparent foreign assistance framework by which the Administration will be making its request for foreign assistance to the Congress.

The first thing that he and the Secretary want to show is that we are doing things that will allow us to meet the overall foreign assistance goal of the United States, which is helping to build and sustain democratic, well-governed states that will respond to the needs of their people and conduct themselves responsibly in the international system.

The framework subdivides the various countries that we provide foreign assistance to into rebuilding countries, developing countries, transforming countries, and sustained partnerships, and we are arranging our various programs under categories that fall generally broadly under peace and security, governing justly, and democratically, investing in people, economic growth, and humanitarian assistance, and you will be able to see and you will be able to make trade-offs once you see how much money has been proposed for a country and how that arrays itself underneath these categories, and you will be able to make trade-offs among programs to have the maximum impact for development assistance.

Mr. TANCREDO. If you don't mind, I do have a couple of questions as I listen, and I am sorry, I was not able to be here for the bulk of your testimony so some of this may be asking you to say things that are redundant and I apologize.

Could you help me understand the process a little bit in terms of how, exactly how the entrepreneur, him or herself, makes contact with the subcontractor. Which way does it flow? Is it a proactive sort of involvement on the part of the subcontractor to go out and find people who actually would be eligible that have some sort of criteria that they have established or is it the other way around? They sit there and somebody comes to then and say I need a loan?

Ms. SCHAFER. The people who work in the developing world that have been involved in this program, and this is now almost 30 years old, have a good understanding of what the demand is. They live there. They work with the community, and they are trying to develop tools that will be beneficial to the people who——

Mr. TANCREDO. How do they actually connect right there on the ground? How does it happen? Who comes where? Do you come to a little office and he says I would like to——

Ms. SCHAFER. People in the community, word gets around on whether an institution that is set up—I had an opportunity to visit a slum in Uganda not so long ago, with a microfinance institution, and it was teeming with people using the microfinance institution. So I am not sure what the origins of it were, but once you are out there providing a service that people need, people will come and take advantage of it.

They make applications, there is information developed that showed that they are able to repay loans or have bank accounts, savings accounts that they can draw on. But exactly how it began 30 years ago, I am not sure I can describe to you.

Mr. TANCREDO. A person who comes in to take advantage of this opportunity, do they have any idea where the money is coming from? Do they know that it is USAID essentially supporting the activity or in conjunction with other nongovernmental organizations?

Ms. SCHAFER. As I mentioned in my opening statement, a case that I am familiar with was a lady I met in Mexico City who has been a customer of FinComun, which is a USAID-assisted microfinance institution. She was very aware that this finance institution was being helped by the United States. She appreciated the services that were provided to her and she was able to create jobs for a number of people who were hired to work in a very small business sewing school uniforms.

Mr. TANCREDO. How do they know that? Is that simply a matter of word of mouth or do we actually—when someone does apply and they obtain the loan, is there something that tells them here is where it comes from?

Ms. SCHAFER. In the first instance I suspect that they know they do their business with the financial institution. More recently we have required that all of the groups that we work with, and many grantees have complied with this as well, brand their activities so that people realize that the United States Agency for International Development is helping to support them. But I think it is well known that at least by the people that I have had an opportunity to deal with that the U.S. is at least one of the donors that is helping to create these institutions.

Mr. TANCREDO. And if a loan goes bad, who has been primarily responsible and takes the hit for it, I guess? Is it the contractor the subcontractor?

Ms. SCHAFER. The finance institution is going to have, you know, a certain number of bad loans and that would be absorbed as part of the costs of doing business but what we are finding is that very, very few of these loans fail to be paid back. There is an extremely high success rate in this program.

Mr. TANCREDO. Do you know the percentage?

Ms. SCHAFER. It is well above 98 percent, I believe. If I am wrong about that, I will correct it for the record.

Mr. TANCREDO. Thank you very much. That is all.

Mr. SMITH. I have some additional questions. One is on the issue of financing. Have we appropriated sufficient money? I think it is about $211 million for this fiscal year for microfinance. Is that enough? Is there a significant unmet need that we should be doing more about? I would say that one of the bills I had put in would have bumped it up to $225 million at some point. But the powers that be thought that was too much. What could we do with more money and is it enough that we have now?

Ms. SCHAFER. A couple of things. One is of course there are a number of well-run programs that really are demanding, competing for the limited development assistance dollars that overall we can provide, and that is always going to be the situation. This program since 2001 has increased from about 156 million to 211 million, so there clearly is a demand out there for this program that has been responded to by the Congress.

The other thing that you should be aware of is that the private sector has invested in microfinance institutions more and more. There is something like $2 billion of capitalization out there by the private sector. They have discovered that this is a money making operation and are willing to invest in it. And people that are in this business have told me that hundreds of millions of dollars, even through raising that money through bond issuance, are pouring into microfinance institutions which can then be loaned to these very small but needy customers.

So this is catching on and this is real sustainability. This is what the program, you know, has wanted to do and aimed to do from the outset and the evidence is mounting that this is happening.

We have also been able to leverage our program somewhat. We have something called the Development Credit Authority, which provides partial credit guarantees to local financial institutions that will actually lend money in local currency in the country. And my testimony points out that we have been able to leverage hundreds of million of dollars with very few million dollars in development assistance funds that will also help capitalize the microfinance institutions. So we have a program ourselves that the private sector is increasingly discovering the benefits of lending in this sector.

Mr. SMITH. Yesterday I hosted a meeting, and many of my colleagues were there, with Salva Kiir, who is, as you know, the First Vice President of Sudan. He is also the President of Southern Sudan. I remember meeting him when he took that position in Khartoum a year ago. We talked about what is needed to rebuild Sudan in general and Southern Sudan in particular, and microfinancing was something he mentioned as being important.

I understand that we are spending some $2 million in microfinancing for Sudan, and I am wondering if there are any plans to significantly ratchet up that money. Is that being spent in Southern Sudan currently? It is just important to me that—I mean for people who have lost everything. As you know, there were 4 million people displaced, 2 million dead in Sudan, and Darfur has its own set of equally egregious problems. Is this a priority for this mission to look at Sudan and see how we might help in the south in rebuilding?

Ms. SCHAFER. I am not familiar in detail with all that they are doing, but I did have a briefing on it last January. We do have a new head of USAID in Sudan now who is probably taking a good comprehensive look at everything that they are doing.

There are so many areas that Sudan needs help with. Education is a particularly big one. Just basic human needs. But to improve the economy there is something that is going to require lots of components and microfinance and microenterprise development work in coordination with other activities, such as agricultural sector development, creating markets for and creating job opportunity for people. So I see this as a tool that would be used by any program for rebuilding Sudan, which is a big enterprise that we will be undertaking in the foreseeable future.

[Additional information follows:]

ADDITIONAL WRITTEN INFORMATION RECEIVED FROM THE HONORABLE JACQUELINE E. SCHAFER TO QUESTION ASKED DURING THE HEARING BY THE HONORABLE CHRISTOPHER H. SMITH

SUDAN

The USAID Mission in Sudan is obligating $2.45 million in FY 2006 to fully fund the current microfinance program, which is a five-year $10 million program focused on Southern Sudan. The project has had a good track record in setting up the first microfinance institution in the difficult operating environment of Southern Sudan. This year, the project is supporting the establishment of a second microfinance institution to target other areas of Southern Sudan. The project has also established a Microfinance Forum for parties interested in good practice in microfinance in Southern Sudan. In addition, a number of NGOs have programs with small grants and revolving funds and are looking to transition to sustainable micro-finance programs.

Rapid expansion in Southern Sudan is difficult for several reasons: lack of banks and common currencies; continuing insecurity in some areas; limited development of markets; low understanding of financial services; limited human resource capacities; and lack of other institutions. USAID's Mission in Sudan intends to remain engaged in this sector and promote expansion as rapidly as conditions and funding allow.

Mr. SMITH. I know Mr. Tancredo notes that he did make an appeal for lifting sanctions on Southern Sudan, that at this point they are counterproductive because it is hurting the victims of that most recent war.

I have two final questions. How can microfinance be integrated and mainstreamed throughout all foreign aid, for example, natural resources and AIDS. I travel a lot, usually going to places where there are grave humanitarian and human rights problems, and when there is a crisis—like during the tsunami, for example, I went to Phuket, and in each of those meetings microcredit was high on the agenda. So there it seemed to be very much front and center, but is it being sufficiently integrated into other areas of aid? Do our missions understand how important this is?

Ms. SCHAFER. I think the program has been increasing, the example I gave of after we have a large program in Iraq that is under way. I think that even in cases where the country is rebuilding and that category coming out of a crisis, there is a demand and a utility for microfinance for so many of the people whose jobs really depend on microenterprise. These are small individual entrepreneurs that don't have a big, you know, Ford Motor Company factory to go to work at. This is where their jobs are. So there is a demand for it and we are seeing our missions use it all over the world. The other question that you posed was the integration with the other programs. I mentioned here that in my testimony also that we are working with our women development program to make microfinance available to women who are recovering from being victims of trafficking of HIV/AIDS. We are working closely with the programs that support that sector with, you know, opportunity for recovery that could involve the kind of assistance that the Microenterprise Development Program gives. And the better—I mean, we would be much better off if we integrated all of our programs to improve the economy so that people can—so that the economy can grow and bring people out of poverty.

I do want to stress that one of the most important elevators of poverty is economic growth itself, and scholars have found we need about a 2 percent annual growth rate in order for people to really grow out of poverty. And so integrating what we need and to make sure that everybody gets to benefit from the growth as well, so that is what the microenterprise program does. It helps broaden the reach of the economic growth programs that a country would pursue.

Mr. SMITH. With regard to amounts and allocations, Africa gets about 20 percent, and it has a disproportionate share of HIV/AIDS victims and general poverty as well. Is there any sense of trying to enhance that, and again, would more resources enable you to do that? There was $32 million for Africa. I would just say, and I congratulate USAID on this, on another trip recently to Ethiopia, I went to a human trafficking shelter where there must have been in excess of 40 women who had been trafficked, mostly into the Middle East, who were the lucky ones that came back and were rescued. They were learning skills and some of them were hoping to get microcredit loans courtesy of the U.S. Government. These women were just amazing. They were making shoes and learning skills, including computer skills, that were extraordinary. They were putting out some very high quality merchandise. And it struck me that it was great, but not enough of it.

Ms. SCHAFER. In Africa we do have several programs. The Microfinance Program I think is smaller than the Microenterprise Development Program. And that is partly because it is so difficult for the African people specifically who live in the rural areas that are so remote from the markets. The costs for them to do business is very, very high. So we are trying to help them develop their businesses as well as the ability to finance the trading of the products that they produce into a local regional store and in some cases international markets.

I went to Kenya in January on a trip and encountered a business development program there that found a market for local avocado growers who get into Europe on a seasonal basis when the trees weren't producing in Southern Africa. And so they found East Africa to produce in the off season. And originally there was a bit of skepticism by the people who are going to import and whether they could actually get a reliable high quality product and this program helped those people develop that reliable high quality product. It was sent to market on a timely basis, but a lot of things had to happen before they were actually able to earn additional income, including improving the quality of the fruit on the tree through grafting and the right kind of pruning and sprays. And I created several industries that supported these farmers as well that were experts in different parts of the productivity chain. Previously those trees were being cut down for firewood.

So the people that understand how to make these market lines work are an important part of the overall economic development and microenterprise picture in Africa. In this case also we did some household level surveys and found that a very large percent of the people that were actually benefiting from this particular program were very poor people, which might not have otherwise been shown in the way we measured very poor people, but when we did this on a household level basis we are finding that they are reaching a lot of people.

So these programs have multiple aspects to them. They are balanced and overall many of them are meeting with real successes that I think we can be proud of.

Mr. SMITH. Thank you so much.

Mr. TANCREDO. The longer that you sit there and talk about it the more questions that keep popping up.

But you mentioned earlier the degree to which you were involved with the remittances and trying to use that in this process. Considering the fact that there are now seven countries, I believe, have more than 10 percent of their GDP made up of remittances from their nationals working in the United States, it amounts to a huge sum of money flowing out of the country, $20 billion to Mexico alone.

How do you interact with that? How does this become part of a business program?

Ms. SCHAFER. The case I am familiar with is in the state of Zacatecas in Mexico, where the treasurer of that state has told us that. We have been working with them to try to be able to raise money in the private sector for infrastructure to build schools and roads and water and waste water facilities, and he has told us that the remittances that come back into his state account for about half of the ability that he has to raise money to pay off the loans that—and the bonds that he has been issuing.

So we are working with them technically to help tap this resource as a development tool. It is larger than official development assistance. Flows up remittances as a percent of the total flows of U.S. capital overseas has now outpaced development assistance in the last 5 or 10 years.

Mr. TANCREDO. Thank you.

Mr. SMITH. Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chairman.

One of the things that I have been asked and I have been especially in Africa traveling is where we have AIDS projects a lot of women have been widowed and that are looking to supplement their income and they can be very resourceful with very small amount of money. We have our big programs like the dairy, the dairy that we do—that is not microenterprise but a lot of the women in particularly have said that it would be very helpful to have access to more microenterprise. Is there any synergy between trying to make sure that more in-country—that we are working on HIV/AIDS if there is an opportunity to kind of seize this as an opportunity to get some microenterprising moving forward and, if so, can you give me some examples of what I should be taking a look at?

Ms. SCHAFER. What USAID has done to make use of the microenterprise program to help people afflicted with HIV/AIDS falls into several categories. The first is research so that we better understand what the needs are of the HIV/AIDS affected clients. We are also trying to innovate new approaches to reach the affected populations. An example of that would be in Zimbabwe, where it seems very simple but it is actually very effective. We are supporting honey production and marketing of what is really a low labor but high return activity for the target group so that the effort needed to actually earn income from this particular agricultural activity is commensurate with their ability to do the work.

Another example is in Ethiopia, where urban household gardens will yield not only better nutrition for patients but also some cash that will help them out. So these are a couple of examples of where we are trying to help.

We also have a policy of including HIV/AIDS clients in main, straight microenterprise programs such as the Opportunity International Bank that is doing this particular work with us. A community focus is needed. HIV/AIDS impacts entire communities. So members of the community——

Ms. McCOLLUM. If I may. Ms. Schafer, I have been in the communities. I understand. You are doing research? You are taking the microenterprise dollars that are allocated and doing research with them? Did I hear you correctly?

Ms. SCHAFER. Our partners are. Part of the work that they are doing with us is to make sure that we understand what the needs of the HIV/AIDS affected clients are and I call this research, but we are basically trying to identify who those clients are and what they need.

Ms. McCOLLUM. Could I get a breakdown in Africa of dollars going directly toward individual families versus how much in microenterprise is going toward identifying—I mean, I think the identification after this many years being in Africa working on this issue should be kind of self-evident. If you could get that to me.

And a little more on your new approach. I think what you are doing in Ethiopia sounds very exciting, but I would like more examples of how those dollars are being spent out of the total dollar amount.

Thank you.

[The information referred to follows:]

WRITTEN RESPONSE RECEIVED FROM THE HONORABLE JACQUELINE E. SCHAFER TO QUESTION ASKED DURING THE HEARING BY THE HONORABLE BETTY McCOLLUM

MICROFINANCE AND HIV/AIDS

Funding for microenterprise programs specifically designed to assist HIV-affected households and communities was approximately $5 million in each of FY 2004 and FY 2005. This amount captures programs that focus on innovations to address the impact of HIV on microfinance institutions and their clients, and to curb HIV transmission. It does not capture the resources going to programs such as FINCA Uganda's microfinance work or Opportunity International Bank of Malawi—programs that work in communities with high rates of HIV/AIDS and can count many HIV-affected people among their clientele.

Early work in microfinance illuminated the hazards of directly targeting people with HIV/AIDS because it so often results in stigma. It also made clear that not just individuals but whole households and communities suffer the effects of high rates of HIV infection. This is why we work in a number of ways to mitigate the impact of HIV on households and communities, and on the financial institutions that serve them. The work we support includes research, which I'll describe, and other methods as well.

One method is what I've discussed, that is, identifying and promoting income generating activities for HIV-affected households. Low-labor, high-return activities such as honey production and urban gardening are particularly suitable for families in which adults' productivity may be compromised by illness.

Another method we support to meet the needs of HIV-affected communities is the method of combining life skills training and behavior change communications with microfinance services. In Tanzania, for example, the Private Enterprise Support Activities Project runs a training program, in conjunction with its rural outreach efforts, that integrates training in sustainable agricultural practices, nutrition, HIV/AIDS prevention, and skills for living with HIV. And in South Africa, USAID has supported the integration of HIV/AIDS prevention activities into all microenterprise and market linkage programs in order to begin to mitigate the wide-ranging economic problems fostered by the disease.

A third method we use to support HIV-affected communities is through developing financial products to meet client needs. In Rwanda, for example, the World Council of Credit Unions conducted research on the amount of money households spend on health care in order to determine what kinds of savings and insurance products and services are appropriate for those communities. They are testing a credit product to help families smooth out payments for health care premiums, which is intended to ease the burden on families but can pose risks for the microfinance institutions, since premium payment is not a productive activity—although it can help enable an infected household member to get the health care they need to continue working.

We also support research in other countries on demand for microinsurance in order to assess whether such products, which are riskier in Africa than in many places, can benefit communities without compromising the stability of the microfinance institutions that offer them. This research also supports development of microinsurance products that could cover opportunistic infections, which most microinsurance products developed to date do not cover; and it has contributed to established guidelines for microinsurance products that can aid MFIs that are assessing whether and what types of microinsurance they may want to add to their offerings.

Finally, in recognition of the ways that microfinance institutions can be affected by illness among their staff as well as among clients, who may default due to medical care costs or their inability to work, we support a training called Defining Options, which helps MFIs assess and plan for the impact of HIV/AIDS on their institutions. This training is designed for managers of microfinance institutions and focuses on working with HIV/AIDS-affected clients, forming strategic alliances with local HIV/AIDS support organizations to better serve clients, monitoring the financial impact of HIV/AIDS on an institution's portfolio, refining products to meet the financial needs of a changing clientele, changing workplace policies to address HIV/AIDS, and handling internal staff issues. In addition, we support the provision of technical assistance to MFIs that have undergone the Defining Options training and have created action plans for their institutions. Trainings for staff have been conducted in Ethiopia, Kenya, South Africa, and Mozambique. Trainings for trainers have been conducted in Uganda, Kenya, South Africa, Zimbabwe, Zambia, Mozambique and Ethiopia.

So, in response to your concern about research, I would argue that the research as well as the product development, institution strengthening, and life skills and behavior change activities that we support all benefit HIV/AIDS-affected families and communities.

Mr. SMITH. Thank you. Ms. Schafer, thank you so much for your leadership. Thank you for being a tremendous witness and we look forward to working with you going forward.

Ms. SCHAFER. Thank you very much, Chairman, Members of the Committee.

Mr. SMITH. I would like to now welcome our second panel, beginning with Mr. Joe Mwangi-Kioi, who is the Director of Monitoring and Evaluation for the Grameen Foundation. He has over 20 years of experience in commercial banking and microfinance. Before joining the Grameen Foundation, he worked in finance for 15 years at the Commercial Bank.

We will then here from Gary M. Woller, who is President of Woller & Associates, an international development consulting firm specializing in microfinance and public policy analysis.

A former academic, Dr. Woller has published numerous articles and scholarly articles on development. He is the co-founder and editor of the *Journal of Microfinance*.

And then finally, we will hear from Ms. Susy Cheston, who is Senior Vice President of Policy for Opportunity International, advocating greater access to microfinancing and AIDS programs to help the poor. She is also Co-Chair of the Microenterprise Coalition. Ms. Cheston co-authored *Empowering Women Through Microfinance* and has written a number of articles on women and microfinance.

Mr. Mwangi-Kioi.

STATEMENT OF MR. JOE MWANGI-KIOI, DIRECTOR OF MONITORING AND EVALUATION, GRAMEEN FOUNDATION USA

Mr. MWANGI-KIOI. Mr. Chairman and Committee Members, good afternoon. I am humbled by the honor given to me to testify on behalf of the Grameen Foundation and the Microenterprise Coalition, and I am grateful for both the opportunity to speak to you today and also to thank you for your past support for microfinance and microenterprise.

I hope that I can add emphasis to the united voice of the microfinance industry for increased support in response to the unheard "silent screams" of the poor in Africa and around the world who are crying out for our help.

Mr. Chairman, I would like to summarize my statement and highlight the important role of microfinance in fighting poverty and the great need for all of us to continue concerted efforts to allocate increased resources and action in support of microfinance.

In this respect, Mr. Chairman, I would like to share some of my personal experiences in microfinance. Eight years ago when I transitioned to microfinance from commercial banking, I was very impressed with the incredible impact of microfinance in transforming the clients' lives.

I remember clearly a poor kiosk operator who was a borrower in the SunLink project of Pride Africa in Nairobi, Kenya, my homeland. He was invited to the launch of another branch to share his story of how he had benefited from a loan of only $50, as new clients were getting their first loans of $50 each.

The man was so happy to share his story and he came smiling broadly from ear to ear and literally bouncing on his toes as he came to the podium. He eagerly narrated how his loan of $50 enabled him to purchase stock for his kiosk which he turned over many times in that month and he was able to repay his loan within 1 month and also increase his stocks and sales.

He advised the new clients to utilize their loans well and emphasize that with his good record he qualified for a second loan of a hundred dollars.

The next story I recall is of a tea kiosk lady who also borrowed $50 in the same project. Within 18 months she had expanded her small shop and even opened a second location through increasing her loan size to $2,500 and investing in and growing her business for her family's future.

These real cases demonstrate the power of microfinance to increase the income generation capacity of the poor and confirm that microfinance is "a hand up, not a hand out."

Mr. Chairman, these are only two of literally millions, and I repeat, millions of success stories of microfinance in Africa and worldwide.

Unfortunately, these successes are but a drop in the ocean of poverty, and there is a compelling need to do more to expand access to microfinance by the poor.

Another example of the power of microfinance is Grameen Foundation's collaboration with the Lift Above Poverty Organization, or LAPO, in Nigeria. With the support of a grant of 1.3 million from USAID over a period of 3 years, Grameen Foundation assisted LAPO to build its capacity for expansion. This was done through institutional strengthening, covering operations, MIS, financial controls and training.

I was the lead consultant on the LAPO assignment and must say I was impressed with their capacity to learn and to serve their communities.

In 3 years they were able to double the number of branches to 36 from 18 and increase outreach to 44,000 borrowers from 18,000.

LAPO currently has 56 branches with plans to further expand and reach 220,000 poor borrowers by 2008. This kind of success, Mr. Chairman, would not have been possible without USAID's support.

In addition to the traditional microfinance business that its clients operate, LAPO is also offering a farming loan product. This is especially important in Nigeria where 75 percent of the people work in agriculture. Today LAPO is the most robust successful microfinance institution in Nigeria.

As for impact of microfinance, Mr. Chairman, research such as Grameen Foundation's white paper titled "Measuring Impact of Microfinance," published in December 2005, clearly shows that microfinance generates strong financial benefits and impacts the entire family of the borrower including increasing income for expenditures for housing, health care, nutrition and education.

Today the Grameen Foundation is working with 52 microfinance partners in 22 countries around the globe reaching 2.2 million borrowers and impacting 11 million people. Our strategic target is to reach 5 million new clients by 2008, impacting 25 million people.

In addition to LAPO in Nigeria, the Grameen Foundation also works in Uganda and Rwanda. As part of our strategy in Africa, we plan to partner with at least 5 additional MFIs by 2007 and then add more by 2009 with plans to reach at least 1 million new clients in Africa by 2010.

To accomplish this goal and to enable all the Microenterprise Coalition members to impact poverty, significant resources will be required. For that reason, Mr. Chairman, I would like to respectfully encourage the Committee to ensure that at least 50 percent of USAID funding is targeted for the very poor, as specified by the act and that not less than 50 percent of the funding shall be directed toward nongovernmental organizations providing services directly to the poor.

In conclusion, Mr. Chairman, I would like to stress that microfinance is a very powerful poverty alleviation strategy. Recent statistics reveal that, by December 2004, 3,194 microfinance institutions reported serving more than 92 million who were poor when they joined their programs. Of these, 67 million were listed as poorest clients. This outreach of poorest clients is a dramatic increase of 776 percent, nearly 800 percent, Mr. Chairman, above 7.6 million poorest recorded to have been served in 1997. This is massive and very impressive progress and needs to be supported in every way possible. But even with these impressive numbers, we are only scratching the surface of global poverty. The current goal is to reach 175 million by 2015 and to do so will require significant resources. For this ambitious goal to be achieved, congressional leadership and support and collaboration with microfinance practitioners and networks like ours for continued focus on providing services to the poor and the poorest is essential. I conclude my remarks, Mr. Chairman, my verbal remarks and thank you very much for the opportunity to testify before you today.

[The prepared statement of Mr. Mwangi-Kioi follows:]

PREPARED STATEMENT OF MR. JOE MWANGI-KIOI, DIRECTOR OF MONITORING AND EVALUATION, GRAMEEN FOUNDATION USA

Mr. Chairman and Members of the House Committee, good afternoon. I am truly humbled by the honor I have been given to appear before you on behalf of Grameen Foundation and the Microenterprise Coalition and I am grateful for the opportunity to testify today. I hope that I can add more emphasis for increased support for microfinance in response to the united voice of the microfinance industry and the unheard "silent screams" of the very poor that we serve in Africa and worldwide through microfinance.

Mr. Chairman and Ranking member Payne, I am excited to have this opportunity to testify as I wish to share some real-life and wonderful experiences to illustrate the key contribution microfinance is making toward poverty alleviation in Africa where there is perhaps the greatest extent of poverty and need for action. Furthermore, I would like to highlight the work of Grameen Foundation and similar microfinance networks in poverty alleviation and to thank you and the Committee and also USAID for the outstanding past support you have given to microfinance and to underscore the importance of further collaboration to ensure full implementation of the Microenterprise Results and Accountability Act of 2004.

Mr. Chairman, I would like to express to you and the Committee our deep gratitude for the leadership that you have shown not only in support of microfinance but also to develop initiatives to address the related human rights and the HIV/AIDS crises. These efforts are benefiting the poor by giving them hope of shaking off the yoke of poverty thereby realizing a life of dignity and freedom. I am sure I speak for all when I say that the microfinance industry would like to do everything possible to ensure success of the cause you are promoting.

Eight years ago, when I transitioned to microfinance from a career in commercial banking, I wondered how an organization could sustainably lend to the poor who did not have collateral and could therefore not qualify or even be able to participate in the formal financial sector. But I learned quickly that not only are the poor bankable, but that lending to them employing microfinance methodologies proved them to be better customers than traditional commercial bank borrowers. This was evidenced by the high rates of repayments of up to 98% in the microfinance sector compared to between 60% and 70% in the commercial bank sector. And within three months, I was convinced that this is a sector I wanted to participate in and especially so when I saw the joy and gratitude of the clients at just being given a very small loan of even as little as $50 which they appreciated for opening the door of enterprise for them.

The first real-life story and experience of a client that I want to share with you is of a borrower who was operating a small kiosk selling miscellaneous provisions such as bread, milk, maize meal, small bottles of Vaseline petroleum jelly, etc. Being a second loan level client of the SunLink project of PRIDE AFRICA in Nairobi, Kenya, he was invited to the launch of one of our other branches where new clients were getting their first loans of $50 each. He was asked to share his experience with the loan of only $50 and how he utilized it in his small business.

I must say I had never seen someone look so happy at being given the opportunity to tell his story. He came with a broad smile from ear to ear and was so excited to share his story that he was literally bouncing on his toes as he came up to the podium. He narrated how he had utilized the amount of the loan to buy a carton of Vaseline. He explained that within two days his carton was all sold out and with the proceeds he invested in another carton. And he explained how turning that loan amount over and over within the month he was able to earn more than enough to pay for the loan and also increase his stocks. He related how he was so grateful to PRIDE AFRICA for having given him the opportunity of a small loan when no bank would. He even advised the new loan recipients to utilize their small loans well to benefit like he did. And he added emphasis to the fact that when his loan was repaid because he was prompt in his repayments without missing his installments he was able to qualify for the next level loan of $100.

The next real-life story also is from Kenya where, as a part of the same project, a tea kiosk lady also borrowed $50 to support growth of her small business. She narrated how with that loan amount she was able to purchase supplies so that she could serve a larger number of patrons during the tea and lunch breaks. She too was able to utilize that first loan to achieve higher earnings and then when she paid off that loan she immediately qualified for the next loan level of $100. She utilized her loans well and expanded her kiosk to its maximum capacity; but she was not satisfied to stop there. She found another place where she could open another kiosk and did so. By the time I left PRIDE AFRICA one and a half years later, she was applying for a loan amount of $2,500. This case clearly demonstrates the power of microfinance to improve a poor borrower's earnings by moving her from capacity for only $50 to an amount fifty times more within a period of 18 months. I would say that is quite impressive.

These are just two of the literally millions, yes millions, of success stories of microfinance clients across Africa and around the world getting the opportunity of improving their earnings and lifting themselves and their families and indeed their communities out of poverty permanently.

Unfortunately these success stories are but a drop in the ocean of the poverty that has devastated many in the African continent. Recent statistics published by the World Bank reveal that Africa receives only 6% of the total dollar investments of donor funds although the recipients comprise 21%. There is therefore a compelling need to do more in the continent through microfinance which has been proven to be an effective solution to alleviating poverty, generating powerful returns beyond income and employment including increased expenditures for housing, health, nutrition, and education that supports transformative development at the household level. Our Board of Directors, which includes one prominent African and many others who are deeply concerned about Africa, has indicated strong interest in us applying the microfinance strategy more broadly on this continent as part of our response to the poverty crisis there.

To this end we at Grameen Foundation have formed a task force as a first step towards increasing and enhancing our work in sub-Saharan Africa. We already have a successful partner in Nigeria, the Lift Above Poverty Organization or "LAPO", an indigenous NGO. Our work with LAPO was funded by USAID under the IGP grant program which spanned three years from 2003 to 2005. Living in Kenya (my home country) at the time, I served as the lead consultant for Grameen Foundation on this project and was able to see a major transformation in the performance of LAPO over the course of three years. (Towards the end of this project I joined Grameen Foundation as director of their global monitoring and evaluation unit.)

Thanks to USAID's support, GF was able to achieve specific targets related to institutional strengthening, automation, outreach, operational and financial self sustainability, portfolio at risk, etc. We were able to accomplish our major targets under the program by enabling LAPO to:

i. increase its number of borrowers to 44,000 from 18,000 in the period of three years

ii. increase branches from 18 to 36

iii. develop the systems and procedures and manuals for internal controls and reporting at the operational level in the branches and also in the Head Office

iv. Structure an effective Internal Audit Department

v. Automate the Head Office and branch operations (a major challenge since many of the branches are located in areas without electricity)

vi. Train the staff on the new systems for effective and controlled operations

vii. Maintain portfolio at risk (PAR)—a way of measuring the repayment performance of clients—at 2% or less

viii. Achieve financial self sustainability (profitability)

On the ground, LAPO is providing a broad range of credit and savings and other products and services directly to the poor, supporting their efforts to grow their own businesses. In this respect, microfinance is really a hand up, not a hand out. LAPO clients operate dress-making shops, small restaurants, and family farms that benefit from loans to purchase fertilizer, seeds, and other essential inputs. This is especially important in Nigeria where approximately 75% of the population is engaged in agriculture.

After the USAID grant, LAPO is now one of the most robust and successful microfinance NGOs in Nigeria (Africa's most populous nation), with growth projected to increase from the current 55,000 clients to 220,000 clients by the end of 2008. Outreach at this level would be impacting more than one million people when family members of the clients are considered. This kind of success would not have been possible without the extensive institutional strengthening work and support that we executed with LAPO. As a practitioner, given this impact, I would say that programs that support service provision directly to the poorest are an appropriate and effective use of public funds granted by USAID. I should note that USAID staff in the Office of Microenterprise Development have been very supportive of us making mid-course corrections during the life of this grant and our partnership with LAPO, and their staff are to be commended for the collegial and flexible way they interacted with Grameen Foundation and LAPO. Within the context of being held accountable for reaching the poorest and achieving results, US AID staff should be given latitude to allow its professionals to be responsive to the fast-changing needs of the microfinance sector and networks like ours. Reporting requirements to Congress from the Office of Microenterprise Development can perhaps be consolidated and simplified to allow the professional staff to focus more on creating an increasing number of success stories like the Grameen Foundation/LAPO experience.

In fact our work in Nigeria has extended far beyond the initial project, as we have played an important role in supporting LAPO to advocate on behalf of supportive microfinance regulations to create an enabling and conducive environment for microfinance institutions to be able to continue serving larger numbers of the poor in their communities. This process will enable MFIs in Nigeria to effectively render services that empower the vulnerable, mainly women and the unskilled, to lift themselves out of the grip of poverty. A more supportive regulatory environment will also lead to partnerships between commercial banks and MFIs like LAPO. We are very close to finalizing a historic transaction that will be a model for commercial bank-MFI partnerships in Nigeria and beyond in the years ahead. Our ultimate goal is to bring microfinance in Nigeria, and indeed elsewhere in Africa and worldwide to scale for greater impact in poverty alleviation.

Further to our work in Nigeria, and as part of our planned enhanced involvement in sub-Sahara Africa, we have already identified several countries where we are formulating plans for entry into the respective microfinance sectors. Our plan provides for a clear strategy to play a key role in the development and management of the microfinance sector in each country in order to have a positive impact on expansion of deeper and broader outreach as well as on the incidence of poverty. Our research is already underway and we project that, we shall have added at least 5 more partners in East, Central and West Africa before the end of 2007 with further additions projected by 2009. This will enable us to facilitate increase of outreach in this needy continent by at least 1,000,000 new clients by 2010. To be able to do this successfully we will need substantial funds to support our efforts. However, these funds are not easily accessible. Given the direct impact on poverty of organizations such as ours and other members of the Microenterprise Coalition, I would renew our call to ensure that US support for microfinance be targeted to organizations that specialize in direct services to the poor. Our networks are directly rendering services to the poor and through such institutions we are able to positively impact the very poor. Mr. Chairman, we therefore appeal to you and your committee to ensure that at least 50% of USAID funding for microenterprise and microfinance programs is reaching the very poor as specified in the Microenterprise Results and Accountability Act of 2004. We also appeal to you to ensure that the FY2007 appropriations process clarifies the Act's requirement to "emphasize the use of implementing partner organizations that meet the requirements stated in the Act"—by which we understood that a majority of resources should go to the not-for-profit organizations and regulated financial institutions that directly provide services to the poor. We are grateful, Mr. Chairman, for your support for appropriations language that clarifies that "not less than 50 percent of the amounts made available for microenterprise and microfinance activities shall be for grants to private nongovernmental organizations, networks, and practitioner institutions that provide loans and financial services to the poor and very poor microentrepreneurs and households."

Mr. Chairman, at Grameen Foundation our work in microfinance extends around the globe where we have 52 partners spread from the MENA region (Middle East and North Africa) to East and South Asia and China and also including Latin America and the Caribbean. Through our work with our partners we have increased outreach by over two million new clients in the last two years and we are on track to achieve our number one strategic goal of reaching five million new clients by 2008. Our number two strategic goal is to ensure that 50% of the clients cross the poverty line within five years of joining the program. In this effort we have made significant progress with our Progress out of Poverty Index (PPI) which is among the poverty measurement tools being reviewed as credible indicators of measurement of progress out of poverty. The PPI is a generalized version of the a ten-point scale developed by the Grameen Bank that tracks clients progress towards living a poverty free life. When all ten indicators are satisfied, a family is determined to be "poverty free" with a reasonable degree of certainty (probably some are poverty free when only 8 or 9 indicators are satisfied). A survey conducted in recent years shows an increasing percentage of Grameen Bank's six million clients are poverty free. The latest survey showed that nearly 60% of them have crossed this threshold. This is due to the innovative work of the Grameen Bank and associated companies created by Professor Muhammad Yunus, and is an inspiration and model for the entire microfinance movement.

The PPI tool is under implementation by several of our partners and we expect that in the near future many in the microfinance industry will use this tool to measure the impact of their programs in poverty alleviation. Continued Congressional support for transparency and accountability in terms of depth of poverty outreach (i.e., focus on the poorest) will be essential to establishing industry standards and performance benchmarks for impact that are now lacking but which the PPI and a few other tools have the potential to address.

Our third strategic goal is to develop three innovations that impact microfinance service delivery and management and facilitate the relevant programs to grow in leaps and bounds. In this strategic plan too Mr. Chairman we are well on the way to achieving our goal. I have already mentioned the PPI which is one of the innovations. The second innovation is the Mifos Project (Mifos) currently under beta test with some of our partners and is slated for official launch at the Microcredit Summit scheduled to be held in November this year in Halifax, Canada. We are very excited about Mifos as we are confident it will change the management of microfinance programs to facilitate more efficient and effective control of clients' accounts and enable management of large volumes of clients. The third innovation is our growth guarantee product through which we are able to tap the capital resources in the local environment for required funding for our partners. We have so far closed five guarantees amounting to $1.6million which through our leveraging agreements will raise a total of $4.2million for on-lending by our partners to their poor clients. In addition to these closed deals we have in the pipeline for 2006 some fifteen guarantees worth $15million which when leveraged are projected to mobilize between $45million and $60million for poverty focused MFIs. These are resources which will enable our partners to reach larger numbers of the poor and contribute to the cause of poverty alleviation.

Mr. Chairman I would like to conclude my statement by again emphasizing the importance of the work of microfinance practitioners and networks like ours to the cause of poverty alleviation. To illustrate this importance I would like to cite statistics released by the Microcredit Summit Campaign. These indicate that by December 2004, microcredit institutions numbering 3164 reported serving over 92million clients who were among the poorest when they started with the program. Of these 66.6million were listed as poorest clients. This number records an increase of a massive 776% in growth from only 7.6million poorest clients served in 1997. The role of the U.S. Congress in supporting microfinance and especially microfinance for the poorest has played an important role in this dramatic progress. But we are still only scratching the surface of the opportunity to scale up microfinance. A new goal has been set by the Microcredit Summit Campaign to increase outreach to 175 million of the world's poorest families by 2015 and ensure that 100 million of those families are out of poverty by then. For these goals to be achieved, Congressional support—in terms of funding and a continued focus on ensuring that the poorest families are the primary beneficiaries of US AID-supported microfinance and microenterprise projects—will be essential.

Mr. Chairman, I have no doubt that this achievement during a period of only seven years gives us results and growth we in the microfinance industry would all like to support in every way possible for the cause of eliminating poverty in the whole world by the optimistically projected 2025. It would surely be a dream come true to see poverty eliminated in my lifetime. As we aim for this very ambitious and noble goal, Mr. Chairman, I would like to propose the following suggestions for review by your committee and incorporation into your policies and procedures to promote and ensure concerted effort and collaborative process for enhanced support to microfinance:

i. The State Department needs to include economic growth and microfinance in each of its country plans

ii. The State through USAID should set global goals for microfinance with the aim of regaining global leadership in microfinance

iii. USAID should set up a process for practitioner input to ensure a collaborative effort to maximize the potential of microfinance

iv. USAID should dedicate additional and increasing resources to microfinance

v. Integrate microfinance, natural resource management, health, AIDS, and MCA, into foreign policy goals

Mr. Chairman Smith and Ranking Member Payne, I want to thank you very sincerely for the opportunity to testify here today. Thank You!

Mr. SMITH. Thank you so very much.

And without objection, the full statements of our witnesses will be made a part of the record.

Dr. Woller?

STATEMENT OF GARY M. WOLLER, PH.D., PRESIDENT, WOLLER & ASSOCIATES

Mr. WOLLER. Mr. Chairman and Members of the Subcommittee, my name is Gary Woller. I am president of Woller & Associates, an international development consulting firm in Salt Lake City, Utah. Thank you for the opportunity to appear before you today to discuss implementation of The Microenterprise Results and Accountability Act of 2004. Before joining the full-time consulting ranks, I was a professor at the Marriott School of Management at Brigham Young University where I researched and wrote extensively on microenterprise development and where I co-founded and edited *Journal of Microfinance*.

In addition to my academic research, I have fulfilled numerous consulting assignments in microenterprise development. As part of this work, I have worked closely with practitioners and practitioner organizations, including several years now as a working group facilitator for the Small Enterprise Education and Promotion Network, which is an association of North American and international microenterprise practitioners. I mention this to underscore my intimate familiarity with both the academic and practitioner aspects of microenterprise development. This background gives me a unique perspective on the microenterprise world I believe which I hope will prove of benefit to the Subcommittee today.

Now, rather than attempt to comment on all aspects of the microenterprise results and accountability act, I will limit my remarks to those aspects about which I have personal knowledge or experience. Some of my remarks will address specific provisions in the legislation. Others will address more general or background issues that are either directly or tangentially related through provisions in the legislation.

I originally became involved in microenterprise development in 1997 when I attended the first microcredit summit in Washington, DC. My interest in the field was motivated by two primary factors. First, I found it a fascinating topic, ripe for academic research. Second, I was drawn by its stated commitment to the ideal of poverty alleviation and to serving poor and marginalized populations. The message of transforming the lives of the poor and marginalized via enterprise development and access to financial services is a compelling one, one I suspect that attracts many Members of the Subcommittee. My interest in academic research has since ebbed and flowed over time depending on my work duties, particularly now that I am consulting full time. But my commitment to the ideal of the transformative power of microenterprise development remains. But while it remains ongoing, it has also undergone significant modification over the years, resulting in what is today a more nuanced and I believe more realistic vision of what microenterprise development is, what it can accomplish, and how it can get us there.

In this light, I take particular interest in the poverty outreach figures reported by the Microenterprise Development Office of USAID for fiscal year 2004. I am aware that the 2005 report was recently released, but I did not have possession of it at the time that I wrote this statement. According to these figures, 28 percent of all funds allocated to microenterprise development in fiscal year

2004 benefited the very poor, including 49 percent of funds allocated for lending and 15 percent of funds allocated for enterprise development. On first blush, these results appear disappointing, particularly the figures related to funding for enterprise development, falling below the 50 percent target established in previous legislation.

I do not recommend however that the Subcommittee read too much into these results for several reasons. To begin with, loan size is an unreliable proxy for poverty. The current loan standard, which is, loans less than $300 in Africa, Asia and the Middle East; less than $400 in Latin America and the Caribbean; and less than $1,000 in Europe/Eurasia, which are presumably indicative of very poor borrowers, is notoriously imprecise. I am particularly skeptical about the $1,000 poverty loan cutoff in Europe/Eurasia which appears far too low to me given the price structure in several of the countries in that region where USAID works. Loan size or average loan size in general is an imprecise proxy for poverty status. Loan size is often as much if not more a function of institutional policy as borrowing capacity. As experience demonstrates, there are several reasons why non-poor borrowers will take out $300, $400 or $1,000 loans. In this sense, the current poverty loan standard is no better or perhaps worse than a rough ballpark estimate. Whether this estimate is too high or too low, no one really knows. The legislative requirement that USAID implement and validate poverty assessment tools by October 2006 is a direct and admirable attempt to circumvent the limitations of the loan size poverty proxy. But this approach too has its share of serious limitations which I will discuss later.

Outreach to women or to rural areas are probably superior proxies of poverty outreach than loan size, as we know indisputably that poverty is disproportionately concentrated among women and rural areas. But even these are imprecise with an unknown level of imprecision. Short of actually measuring poverty, a preferable approach would be some combination of poverty proxies and perhaps combine them into a simple poverty scorecard in a way that compensates for the individual weaknesses of each proxy. One might also argue that savings constitute a better indicator of poverty outreach than loans. There are millions of poor people who do not want enterprise loans but who want access to secure formal savings. In contrast, there are comparatively few who want enterprise loans but not savings. In almost every microfinance institution which offers both loans and voluntary savings for non-borrowers, the number of savers far exceeds the number of borrowers, and I suspect a nontrivial percentage of those savers come from the ranks of the poor. The industry's emphasis on loans over savings does not reflect any higher truth per se but is the result of the idiosyncratic way in which the industry has developed. It is a development that I consider unfortunate. Not surprisingly, Congress has adopted the industry's bias into its own thinking and policy approach, again, I think unfortunately. Now I am not suggesting that the focus ought to shift disproportionately to savings over loans, but I am suggesting that an approach that grants more emphasis to savings and which acknowledges its critically important role as a livelihood and coping tool among low-income populations in developing countries.

Now the figures for USAID support for enterprise development benefiting the very poor are even more imprecise and substantially so than those relying on the loan poverty proxy. The truth is that the vast majority of enterprise support programs have no clue whatsoever as to the poverty status of their clients. No one knows what criteria they are using to determine the poverty status, including sometimes the programs themselves and the criteria used vary widely from program to program, often evolving down to a wild guess. If the loan size proxy represents a rough ballpark guess, the estimates of poverty outreach among USAID-supported enterprise support programs represent a complete stab in the dark. I would not recommend that anybody makes policy on the basis of these figures.

That said, I also believe that requiring poverty outreach figures for USAID-supported microenterprise programs is probably inappropriate, not that they measure poverty but requiring this as part of what is necessary to get funding. The basis for this statement hinges on what we believe the purpose of enterprise support to be. To me, the purpose of enterprise support is private sector development or, in other words, facilitating the emergence of a dynamic and growing private sector that provides, among other things, jobs, opportunities and a decent standard of living for low-income persons. By and large, enterprises operated by the very poor lack the dynamism and growth prospects that would create the types of jobs, opportunities and standards of living implied here. In my experience, the vast majority of enterprises supported by the typical microfinance NGO targeting the very poor or poor operate in the petty trading or service sector and have on average zero to one paid employees. These characteristics moreover will remain fairly consistent for a particular borrower during the lifetime of the enterprise.

While I by no means intend to belittle the importance of financial services or enterprise development support to this group of enterprises—both are extremely important—they are important for reasons other than employment creation or creating the dynamic and growing private sector.

The enterprises that possess the dynamism and growth potential to create jobs and economic activity and drive private sector development will tend to be found more among the larger of the microenterprises or among the smaller medium enterprises operated by the not-so-poor and often even by the non-poor. To the extent we wish to monitor the outreach or impact of enterprise development support on poverty, I believe it is more appropriate and important to view it from the perspective of paid employment creation or in creation of economic opportunities among the very poor than direct outreach to the very poor. Focussing on the latter purpose instead of the former purpose creates a risk of producing the wrong set of policies, policy incentives and policy outcomes. Better yet, enterprise development support will target a wide variety of interventions at different levels of the value chain, including financial service providers, input providers, buyers, trade associations and so forth, many of which serve multiple markets, including the not-very-poor or non-poor or are themselves large operations.

I now turn to the legislative requirement that USAID implement and validate poverty assessment tools by October 2006. I initially supported this legislation. At the time, many microfinance institutions were claiming to reach the very poor but were in fact not reaching the very poor or more commonly had no idea whether they were reaching the very poor. Out of the thousands of the MFIs operating then, no more than a small handful of MFIs even attempted to assess the poverty status of their clients, which by the way continues today. And those who did, a significant portion were collecting and reporting information lacking in both accuracy and credibility. Consequently, I felt at the time that the legislation would serve to force the industry to be transparent about its poverty outreach, something which the industry apparently would not do on its own. So I enthusiastically supported it.

In hindsight and with the benefit of experience, I now believe this legislation to have been misguided, well intentioned, but misguided nonetheless. The reasons for this are both conceptual and practical. Conceptually, I think that the legislation's focus on the very poor is inappropriate. The legislation's focus on the very poor is no doubt a direct result of the industries insistence that microfinance be targeted to the very poor or to take the more extreme rhetoric, the poorest of the poor. I understand fully this insistence, and I share the commitment to pushing the frontier of finance progressively down the socioeconomic ladder. The vision of reaching the poorest of the world with formal financial services is a vision we are striving for, but it is also an unduly limiting vision if that is its primary focus.

The fact is that there remains hundreds of millions of people throughout the world who still lack access to formal financial services, and a large percentage of these are people are neither very poor nor even poor according to absolute or local poverty standards. Yet they are no less deserving and no less needful than the very poor. In many cases, moreover, they are also the very people who own and operate the dynamic growth-oriented businesses capable of driving private sector development.

Poverty in developing countries is a dynamic, not a static concept. People are continually moving in and out of poverty, depending on a whole host of factors, some of which they control, but many of which they do not and among which access to financial services is rarely the most important. These include people clustering around the poverty line and people further away from the poverty line. Many people who are not officially poor today are but one shock from falling below the poverty line or perhaps even further. Vulnerability is one of the distinguishing characteristics of the masses of the developing world, both poor and non-poor. A poverty assessment tool provides no more than a snapshot in time that does not capture the dynamism of poverty or the vulnerability of the masses. Unfortunately there are no practical tools to measure vulnerability. And if there were, I am not sure they wouldn't be preferable to a poverty assessment tool.

Mr. SMITH. Dr. Woller, I hate to say this, but we have 3 minutes to report to the Floor to vote. If you wouldn't mind suspending, we will reconvene after the first vote in deference to your time, and then we have three votes that follow, but there is some intervening space. So we will stand in recess for a very, very short period of time. Sorry about that.

[Recess.]

Mr. SMITH. We will resume this hearing. And again, I apologize for the interruption.

Dr. Woller.

Mr. WOLLER. Thank you. I am going to, in the interest of time, cut my remarks short and try to get to the highlights so that we can leave time for Susy and for questions at the end.

Let me start by saying, so that my remarks are not misconstrued, I have absolutely no objection to targeting the very poor people or poor people with financial services or any other form of the development assistance. My remarks refer specifically to the legislative mandate requiring this and to the particular conceptual and practical issues relating to these particular sets of tools that are being developed. Let me just sort of jump—my major concern with this particular approach is I think, in the end, it is a non-scalable approach, meaning that at the end of the day, the institutions which either have a very firm poverty lending commitment or those institutions who are seeking money from USAID will include I think a very small subset of all the microfinance institutions and microenterprise support institutions out there.

I think there are better ways to do it, which takes me to where I have the section on creating social transparency as preferred to measuring poverty outreach. And I will just pick up there. Rather than attempt to push MFIs to serve a particular clientele, I think that the underlying goal ought to be transparency, transparency by the MFI social performance. Let the MFI choose which market segment it wants to serve but then hold it accountable for demonstrating that it is reaching this market and that it is doing a good job in the process. Armed with this information, donors and investors can then make informed decisions about which MFIs to support and, by extension, which clientele to support. Transparency will lead to accountability ultimately and to a more efficient and to greater information so that we can have a more efficient and effective allocation not only of resources and to the industry but also more effective policy making.

And if social transparency is the goal, which I think it should be, I think poverty assessment is an ineffective way to reach the goal. True social transparency requires scale; that is widespread disclosure of credible information about social performance. Regardless of which poverty assessment tools are used, no more—oh, excuse me—regardless of which poverty assessment tools are developed under the current process, no more than a relatively small handful of MFIs will bother to use the tools, including those MFIs seeking USAID funding support and those MFIs with a powerfully motivating commitment to poverty outreach. This does not include the large numbers of commercially oriented MFIs serving diverse market segments and the large universe of MFIs residing outside the influence of USAID. There are better approaches to creating social transparency and ways that have potential to achieve scale such that they hold potential for transforming the entire industry, including those MFIs not otherwise interested in adopting USAID-certified poverty tools. USAID is currently playing a role in helping develop these approaches and its involvement in this effort I think should be encouraged by the Subcommittee.

Now, I am going to skip to the brief comment on the allocation of funding to NGOs versus PVOs, NGOs and PVOs versus for-profit consulting firms. Allow me to comment briefly also in the provisions in the Microenterprise Results and Accountability Act of 2004 related to the relative distribution of USAID funding to NGOs and PVOs and to for-profit consulting firms. I understand the basis for this provision, and I agree in principle with certain aspects of its underlying premise. I would caution, however, against taking the arguments too far. The technical and other capacities of NGOs and PVOs differ broadly from those of consulting firms. At the moment, NGOs and PVOs may enjoy some cost advantages in certain situations, but as they are asked to take on more and more technical tasks formerly performed by consulting firms, their cost structures are likely to change as they acquire the resources and expertise necessary to perform these tasks. They draw, after all, largely from the same resource pool as the consulting firms, particularly in terms of upper-tier skills and experience. Consulting firms are good at what they do, and what they do at times differs from NGOs and PVOs. The converse is also true. Rather than attempt to force the two to become more like each other, I believe it is preferable to identify the relative comparative advantages and to direct USAID funding in a way that takes optimal advantage of them, and I would add as well I think one of the comparative advantages to the NGOs and PVOs is the on-the-ground experience to do experimentation and to innovate. I think that is particularly the area where they shine, and to the extent that we try to redirect funding to the NGOs and PVOs, I would recommend that we try to do it in a way that really encourages experimentation, innovation, and I will come to that again real briefly. More broadly, I would advise the Subcommittee against any temptation to force the development of the industry down one path or another or to use its legislative and budgetary powers to favor one set of models over another. The industry is dynamic, and it is evolving, and it is evolving differently in different countries. The NGO model dominates in countries as diverse as Bangladesh and Nicaragua. All other countries, such as Indonesia, Bolivia or Ecuador, have largely gone the commercial route. India has its own unique approach in the self-help group model grafted onto its dense network of rural finance institutions. We find that some poverty-focused NGOs reach very few, very poor or poor persons while we find that some highly commercialized finance institutions reach a large number of poor persons.

While there may be some general trends, there also appear to be sufficient exceptions that we should be wary about relying too heavily on generalizations. I believe the Subcommittee is sincere in its support of microenterprise development. The Microenterprise Results and Accountability Act of 2004 is evidence of this. The act itself does some good things to advance the agenda of microenterprise development, but it is nonetheless only chipping away at the margin. If I were asked to advise the Subcommittee on what it and by extension USAID could do to exert an even greater impact on the industry, here is what I would recommend: Encourage and support continued innovation and experimentation. The industry has successfully pushed the production possibility frontiers, but they can still be pushed down further. But to push the frontiers to their limits will require innovation and experimentation in addition to the will and resources to support it.

Encourage and support innovation and experimentation and product development. This includes development of loan and other financial products but most importantly of savings products. The industry's emphasis on credit over savings is an unfortunate remnant of its development patterns even though the demand for savings among low-income populations far exceeds the demand for credit.

Much more can still be done to extend outreach to poor marginalized populations, particularly in rural areas. Rural enterprise development and rural finance are perhaps the keys to breaking through existing barriers to achieving truly deep outreach. If reaching the very poor remains a policy objective, this can best be done by encouraging innovation and experimentation in expanding outreach to rural areas.

Encourage and support commercialization where it makes sense not as a blind policy that is for commercialization, but in cases where it makes good sense. The long-run policy objectives in microenterprise development are most likely to be achieved at significant scales via a large network of commercially oriented although not necessarily for-profit institutions. This should not mean support should focus solely on commercialized institutions. There will be an ongoing important role for NGO and PVO sectors, particularly in terms of innovation, experimentation and serving hard-to-reach populations.

Encourage and support commercialization in part via transitioning institutions to private market funding. We all know that the capital markets offer funding potential far in excess of what the donor community can offer. And as USAID helps institutions to make the transition to private market funding, its own funding should be directed more and more toward those institutions which are innovating and experimenting, and particularly in rural areas and to other hard-to-reach populations.

Encourage and support initiatives aimed at creating wide-scale social transparency and accountability. Were you to achieve this, I honestly think the impact would be far in excess above the current poverty tools initiative, particularly in terms of scale and the impact a scale would have, the transformative impact scale would have on the industry.

Encourage and support development of enterprises with greater potential to create jobs and opportunities for low-income people. This includes in many cases larger businesses run by people who may not be very poor but who may be poor or even above the poverty line. These are the businesses that are most likely to drive economic growth.

Assist supported institutions to develop functioning and effective monitoring systems. The current state of monitoring systems among development institutions is weak to moderate with, I think, important impacts on the effectiveness of policy.

And finally, fund selective high-quality and credible impact assessments. It is unnecessary to perform impact assessments of every or even several USAID-supported programs, but there is a real advantage to be gained by performing a relatively small number of selected impact assessments of programs that offer high potential for yielding important learnings for future policymaking and funding allocation decisions. This includes in particular programs taking innovative approaches to achieving important policy objectives.

Thank you for the opportunity to address the Subcommittee today on these important issues.

[The prepared statement of Mr. Woller follows:]

PREPARED STATEMENT OF GARY M. WOLLER, PH.D., PRESIDENT, WOLLER & ASSOCIATES

Mr. Chairman and Members of the Subcommittee, my name is Gary Woller. I am the President of Woller & Associates, an international development consulting firm in Salt Lake City, Utah. Thank you for the opportunity to appear before you today to discuss implementation of the Microenterprise Results and Accountability Act of 2004. Before joining the full-time consulting ranks, I was a professor at the Marriott School of Management at Brigham Young University, where I researched and wrote extensively on microenterprise development and where I co-founded and edited the Journal of Microfinance. In addition to my academic research, I have fulfilled numerous consulting assignments in microenterprise development. As part of this work, I have worked closely with practitioners and practitioner organizations, including serving several years now as a working group facilitator for the Small Enterprise and Education Promotion (SEEP) Network, which is a professional association of North American and international microenterprise practitioners. I mention this to underscore my intimate familiarity with both the academic and practitioner aspects of microenterprise development. This background gives me a unique perspective on the microenterprise world, which I hope will prove of benefit to the Subcommittee today.

Rather than attempt to comment on all aspects of the Microenterprise Results and Accountability Act, I will limit my remarks to those aspects about which I have personal knowledge or experience. Some of my remarks will address specific provisions in the legislation; others will address more general, or background, issues that are either directly or tangentially related to provisions in the legislation.

Outreach to the Very Poor by USAID-Supported Microenterprise Institutions and the Validity of Reported Figures

I originally became involved in microenterprise development in 1997, when I attended the first Microcredit Summit in Washington, DC. My interest in the field was motivated by two primary factors. First, I found it a fascinating topic ripe for academic research. Second, I was drawn by its stated commitment to the ideal of poverty alleviation and to serving poor and marginalized populations. The message of transforming the lives of the poor and marginalized via enterprise development and access to financial services is a compelling one; one I suspect that attracts many members of this Subcommittee. My interest in academic research has ebbed and flowed over time depending on my work duties, particularly now that I am consulting full time, but my commitment to the ideal of the transformative power of microenterprise development remains on-going. But while on-going, it has also undergone significant modification over the years resulting in what is today a more nuanced, and I believe more realistic, vision of what microenterprise development is, what it can accomplish, and how it can get us there.

In this light, I take particular interest in the poverty outreach figures reported by the Microenterprise Development Office of USAID for fiscal year 2004. (I do not have the figures for fiscal year 2005, although I assume they are similar.) According to these figures, 28 percent of all funds allocated to microenterprise development in fiscal year 2004 benefited the very poor, including 49 percent of funds allocated for lending and 15 percent of funds allocated for enterprise development. On first blush, these results appear disappointing, particularly the figures related to funding for enterprise development, falling below the 50 percent target established in previous legislation. I do not recommend, however, that the Subcommittee reads too much into these results, for several reasons.

To begin with, loan size is an unreliable proxy for poverty. The current poverty loan standard (loans less than $300 in Africa, Asia, and the Middle East; less than $400 in Latin America/Caribbean; and loans less than $1,000 in Europe/Eurasia are indicative of a "very poor" borrower) is notoriously imprecise. I am particularly skeptical about the $1,000 poverty loan cutoff in the Europe/Eurasia region, which appears far too low to me given the price structure in several of the countries in that region where USAID works. Loan size, or average loan size, in general is an imprecise proxy for poverty status. Loan size is often as much, if not more, a function of institutional policy as borrowing capacity. As experience demonstrates, there are several reasons why non-poor borrowers will take out $300, $400, or $1,000 dollar loans. In this sense, the current poverty loan standard is a no better, and perhaps worse, than a rough ballpark guess. Whether the guess is too high or too low, no one really knows. The legislative requirement that USAID implement and validate poverty assessment tools by October 2006 is a direct and admirable attempt to circumvent the limitations of the loan size poverty proxy, but this approach too has its share of serious limitations, which I will discuss later.

Outreach to women or to rural areas are probably superior proxies of poverty outreach than loan size, as we know indisputably that poverty is disproportionately concentrated among women and in rural areas. But even these are imprecise, with an unknown level of imprecision. Short of actually measuring poverty, a preferable approach is to use some combination of poverty proxies and perhaps combine them into a simple poverty scorecard in a way that compensates for the individual weaknesses of each proxy.

One might also argue that savings constitute a better indicator of poverty outreach than loans. There are millions of poor persons who do not want enterprise loans but who want access to secure formal savings. In contrast, there are comparatively few who want enterprise loans but not savings. In almost every microfinance institution (MFI) that offers both loans and voluntary savings for non-borrowers, the number of savers far exceeds the number of borrowers, and I suspect that a non-trivial percentage of those savers come from the ranks of the poor. The industry's emphasis on loans over savings does not reflect any higher truth per se but is the result of the idiosyncratic way in which the industry has developed. It is a development that I consider unfortunate. Not surprisingly, Congress has adopted the industry's bias into its own thinking and policy approach, again unfortunately. I am not suggesting that the focus ought to shift disproportionately to savings over loans, but I am suggesting an approach that grants more emphasis to savings and which acknowledges its critically important role as a livelihood and coping tool among low-income populations in developing countries.

The figures for USAID support for enterprise development benefiting the very poor are even more imprecise, and substantially so, than those relying on the loan size proxy. The truth is that the vast majority of enterprise support programs have no clue whatsoever as to the poverty status of their clients. No one knows what criteria they are using, including sometimes the programs themselves, and the criteria used vary widely from program to program, often devolving down to a wild guess. If the loan size proxy represents a rough ballpark guess, the estimates of poverty outreach among USAID-supported enterprise support programs represent a complete stab in the dark. I would not recommend that anybody makes policy on the basis of these figures.

Appropriateness of Requiring Information on Poverty Outreach of USAID-Supported Enterprise Development Programs

That said, I also believe that requiring poverty outreach figures for USAID-supported microenterprise programs is probably inappropriate. The basis for this statement hinges on what we believe the purpose of enterprise support to be. To me, the purpose of enterprise support is "private sector development," or in other words, facilitation of the emergence of a dynamic and growing private sector that provides, among other things, jobs, opportunities, and a decent standard of living for low-income persons. By and large, enterprises operated by very poor persons lack the dynamism and growth prospects that would create the types of jobs, opportunities, and standards of living implied here. (This is a very broad generalization to which there will be numerous exceptions.) In my experience, the vast majority of enterprises supported by the typical microfinance NGO targeting the very poor or poor operate in the petty trading or service sector and have on average 0–1 paid employees. These characteristics, moreover, will remain fairly consistent for a particular borrower during the lifetime of the enterprise. While I by no means intend to belittle the importance of financial services or enterprise development support to this group of enterprises (both are extremely important), they are important for reasons other than employment creation or creating a dynamic and growing private sector.

The enterprises that possess the dynamism and growth potential to create jobs and economic activity and drive private sector development will tend more to be found among the larger of the microenterprises or among the small or medium enterprises operated by the not-so-poor and often even by the non-poor. To the extent we wish to monitor the outreach or impact of enterprise development support on poverty, I believe it is more appropriate and important to view it from the perspective of paid employment creation or creation of economic opportunities among the very poor rather than direct outreach to the very poor. Focusing on the latter purpose instead of the former purpose creates the risk of producing the wrong set of policies, policy incentives, and policy outcomes. Better yet, enterprise development support will target a wide variety of interventions to different levels of the value chain, including financial service providers, input providers, buyers, trade associations, etc., many of which serve multiple markets (including the not very poor) or are themselves large operations.

Conceptual Problems with Measuring Outreach to the Very Poor

I now turn to the legislative requirement that USAID implement and validate poverty assessment tools by October 2006. I initially supported this legislation. At the time (and continuing today), many microfinance institutions (MFIs) were claiming to reach the very poor, but who were in fact not reaching the very or, most commonly, had no idea whether they were reaching the very poor. Out of the thousands of MFIs operating then, no more than a small handful of MFIs even attempted to assess the poverty status of their clients, and of those who did, a significant portion were collecting and reporting information lacking in both accuracy and credibility. (This trend continues today.) Consequently, I felt at the time that the legislation would serve to force the industry to be transparent about its poverty outreach, something which the industry apparently would not do on its own. So, I enthusiastically supported it.

In hindsight, and with the benefit of experience, I now believe this legislation to have been misguided; well-intentioned, but misguided nonetheless. The reasons for this are both conceptual and practical. Conceptually, I think that the legislation's focus on the "very poor" is inappropriate. The legislation's focus on the very poor is no doubt a direct result of the industry's, or certain members of the industry's, insistence that microfinance be targeted to the very poor, or to take the more extreme rhetoric the "poorest of the poor." I understand fully this insistence, and I share the commitment to pushing the frontiers of finance progressively down the socio-economic ladder. The vision of reaching the poorest of world with formal financial services is a vision worth striving for, but it is also an unduly limiting vision, if that is its primary focus. The fact is that there remain hundreds of millions of people throughout the world who still lack access to formal financial services, and a large percentage of these people are neither very poor nor even poor according to absolute or local poverty standards. Yet they are no less deserving and no less needful than the very poor. In many cases, moreover, they are also the very people who own and operate the dynamic, growth-oriented businesses capable of driving private sector development.

Characteristics of Poverty in Developing Countries

Poverty in developing countries is a dynamic, not a static, concept. People are continually moving in and out of poverty depending on a whole host of factors, some of which they control but many of which they do not, and among which access to financial services is rarely the most important. These include people clustering around the poverty line and people further from the poverty line. Many people who are not officially poor today are but one shock away from falling below the poverty line or perhaps even further. Vulnerability is one of the distinguishing characteristics of the masses in the developing world, both poor and non-poor. (Notably also financial services are one of the primary tools the masses use to manage their vulnerability.) A poverty assessment tool provides no more than a snapshot in time that does not capture the dynamism of poverty or the vulnerability of the masses. Unfortunately, there are no practical tools to measure vulnerability. If there were, I am not sure they would not be preferable to a poverty assessment tool.

It is common parlance in the industry today to refer to groups such as the "very poor," "poor," "marginally poor," "vulnerable non-poor," and "non-poor." Tens of millions of people belong in each of these groups, all deserving and potentially benefiting from access to formal financial services. It should be remembered also that absolute poverty standards (such as the dollar a day standard) do not capture the fact that someone living on $1.40 a day, or even on $2 a day, still enjoy living standards far below what we in the developed world would consider acceptable. I would bet that if members of this sub-committee were to travel to a rural community or urban slum in a poor developing country and were asked to identify those living on less than $1 a day and those living on more than $1 a day, they would be very hard pressed to tell the difference. In short, a focus on the very poor is an arbitrary standard that excludes millions of deserving and needful persons who enjoy relatively low standards of living by virtually any other standard and who are highly vulnerable to shocks that can quickly and easily send them spiraling downward.

Creating Social Transparency Preferred to Measuring Poverty Outreach

Rather than attempt to push MFIs to serve a particular clientele, I think that the true underlying goal ought to be transparency; transparency about an MFI's social performance. Let the MFI choose which market segment it wants to serve, but then hold it accountable for demonstrating that it is reaching this market and that it is doing good job in the process. Armed with this information, donors and investors can then make informed choices about which MFIs, and by extension which types of clientele, they want to support. Transparency leads to accountability and accountability and to an informed and efficient market and to informed and effective policymaking.

If social transparency is the goal, and I think it should be, then poverty assessment is an ineffective way to reach the goal. True social transparency requires scale; that is widespread disclosure of credible information about social performance. Regardless of which poverty assessment tools are developed, no more than a relatively small handful of MFIs will bother to use the tools, including those MFIs seeking USAID funding support and those MFIs with a powerfully motivating commitment to poverty outreach. This does not include the large numbers of commercially-oriented MFIs serving diverse market segments and the large universe of MFIs residing outside the influence of USAID. There are better approaches to creating social transparency and ways that have potential to achieve scale, such that they hold potential for transforming the entire industry, including those MFIs otherwise not interested in adopting USAID-certified poverty tools. USAID is currently playing a role in helping to develop these approaches, and its involvement in this effort should be encouraged by this Subcommittee.

Practical Problems with Measuring Outreach to the Very Poor

The practical issues involved in developing USAID-certified poverty tools have come to light in the years since the legislation was passed. The IRIS Center has, in my opinion, done a heroic job in developing credible poverty assessment tools, but I remain unconvinced that they will prove practical across a wide spectrum of institutions and contexts. There is not enough money currently budgeted to develop poverty assessment tools for every country that receives USAID funding support for enterprise development. We know that the nature and determinants of poverty can vary widely from country to country, even within regions. Yet, we are facing the prospect of using a poverty tool developed in one country to assess poverty in another country without knowing how accurately it does so. There will thus always be legitimate doubts as to the credibility of these tools, despite the tremendous cost and effort that has gone into ensuring their accuracy and credibility. Can one really conclude with confidence that a poverty assessment tool developed using data from Uganda accurately and credibly measures poverty in Malawi? In the end, we are back to using ballpark estimates, which is precisely where we started, and we do not know, although we might suspect, that the new ballpark estimate is better than the old one.

Another practical issue is the difficulty in making meaningful distinctions between the very poor and the not very poor. The IRIS Center appears to have found a way to deal with this using some sophisticated econometric modeling, but this does not answer the question as to whether someone living on $0.98 a day is materially worse off, and thus more needful or deserving, than someone living on $1.08 a day. If you look at the data, I think you will find a very tight clustering of people around the very poor cutoff line, which helps explain the econometric difficulties IRIS faced in making the distinction. I am not sure what legitimate policy objective is serves to determine that those clustering below this line are deserving of USAID support and those clustering above it are not.

Yet another issue in the legislation is that it requires only that distinctions be made between the very poor and not very poor. What about the poor? If I am an MFI, knowing whether someone is very poor is helpful, but knowing also whether someone is poor is more helpful yet. The practical usefulness of a tool that measured poverty would be significantly greater and would be more likely to be adopted by a large number of institutions than a tool that only determines whether someone is very poor. Many MFIs are not interested in the very poor as a target market, but they are, or would be, interested in the poor as a target market. The legislation's focus on the very poor was in hindsight a significant error that will limit is usefulness and scope to the industry as well as to USAID. To be honest, I do not know how the IRIS Center is dealing with this issue. It may be adjusting its tools to allow them to identify the poor as well as the very poor, but if at the end of the day all we have a set of tools that allow us only to identify the very poor, I think that will be a great tragedy.

NGOs and PVOs vs. For-Profit Consulting Firms

Allow me to comment briefly also on the provisions in the Microenterprise Results and Accountability Act of 2004 related to the relative distribution of USAID funding to NGOs and PVOs and to for-profit consulting firms. I understand the basis for this provision, and I agree in principle with certain aspects of its underlying premise. The 2004 figures reported by the Microenterprise Development Office suggest that this provision has had some impact, or at the very least that it is being fulfilled. I would caution, however, against taking the arguments too far. The technical and other capacities of NGOs and PVOs differ broadly from those of consulting firms. At the moment, NGOs and PVOs may enjoy some cost advantages in certain situations, but as they are asked to take on more and more technical tasks formerly performed by consulting firms, their cost structures are likely to change as they acquire the resources and expertise necessary to perform the tasks. They draw largely from the same resource pool as the consulting firms, particularly in terms of upper tier skills and experience.

Consulting firms are good at what they do, and what they do at times differs from NGOs and PVOs. The converse is also true. Rather than attempt to force the two to become more like each other, I believe a preferable approach (broadly applied) is to identify their relative comparative advantages and to direct USAID funding in a way that takes optimal advantage of them.

Conclusion

More broadly, I would advise the Subcommittee against any temptation to force the development of the industry down any one path or another or to use its legislative and budgetary powers to favor one set of models over another. The industry is dynamic, and it is evolving. And it is evolving differently in different countries. The NGO model dominates in countries as diverse as Bangladesh and Nicaragua, while other countries such as Indonesia, Bolivia, or Ecuador have largely gone the commercial route. India has its own unique approach in the self-help group model grated onto its dense network of rural financial institutions. We find that some "poverty focused" NGOs reach few very poor or poor persons, and we find that some highly commercialized financial institutions reach large numbers of poor persons. While there may be some general trends, there also appear to be sufficient exceptions that we should be wary about relying too heavily on generalizations.

I believe that this Subcommittee is sincere in its support of microenterprise development. The Microenterprise Results and Accountability Act of 2004 is evidence of this. The Act itself does some good things to advance the agenda of microenterprise development, although I question the appropriateness and efficacy of the poverty tools requirement), but it is, nonetheless only chipping away at the margin. If I were asked to advise the Subcommittee on what it, and by extension USAID, could do to exert an even greater impact on the industry, here is what I would recommend:

- Encourage and support continued innovation and experimentation. The industry has successfully pushed the production possibility frontiers, but they can still be pushed further, and possibly much further. But to push the frontiers to their limits will require innovation and experimentation in addition to the will and resources to support it.
- Encourage and support innovation and experimentation in product development. This includes develop of loan and other financial products but most importantly of savings products. The industry's emphasis on credit over savings is an unfortunate remnant of its development patterns even though the demand for savings among low-income populations far exceeds the demand for credit.
- Much more can still be done to extend outreach to poor and marginalized populations, particularly in rural areas. Rural enterprise development and rural finance are perhaps the keys to breaking through existing barriers to achieving truly deep outreach. If reaching the very poor remains a policy objective, this can best be done by encouraging innovation and experimentation in expanding outreach to rural areas.
- Encourage and support commercialization where it makes sense. The long-run policy objectives in microenterprise development are most likely to be

achieved at significant scale via a large network of commercially oriented (often although not necessarily for-profit) institutions. This does not mean, however, that support should focus solely on commercialized institutions. There will still be an ongoing and important role for the NGO and PVO sector, particularly in terms of innovation, experimentation, and in serving hard-to-reach populations.

- Encourage and support commercialization in part via transitioning institutions to private market funding. Penetrating even a tiny faction of the world capital markets offers funding far in excess of anything available through USAID and the rest of the donor community. As USAID helps institutions make the transition to private market funding, its own funding should increasingly go to supporting innovation and experimentation. The public goods aspect of innovation and experimentation in microenterprise development make it likely that private markets will grossly underinvest in the types of innovation and experimentation necessary to extend outreach to hard-to-reach populations.
- Encourage and support initiatives aimed at creating wide-scale social transparency and accountability in the industry. Were the industry able to achieve this outcome, the total impact would surpass by large multiples the impact of the poverty tools legislation.
- Encourage and support development of enterprises with greater potential to create jobs and opportunities for low-income persons. Support should be targeted to all levels of the value chain as appropriate. Many of the very poor or poor do not want to own or operate enterprises, but they do want paid employment, and the best way to help these people is to facilitate the development and growth of the private sector and its job creation capacity.
- Assist supported institutions to develop functioning and effective monitoring systems. The general quality of monitoring systems among USAID-supported institutions is weak to moderate, which likely has significant adverse impacts on institutional, and thus policy, effectiveness.
- Fund selective, high-quality, and credible impact assessments of USAID-supported programs. It is unnecessary to perform impact assessments of every, or even several, USAID-supported programs. But there is real advantage to be gained by performing a relatively small number of selective impact assessments of programs that offer high potential for yielding important learnings for future policymaking and funding allocation decisions. This includes in particular programs taking innovative approaches to achieving important policy objectives.

Thank you for the opportunity to address the Subcommittee on these important issues.

Mr. SMITH. Dr. Woller, thank you very much for your testimony. I look forward to asking some questions.

Ms. Cheston, please proceed.

STATEMENT OF MS. SUSY CHESTON, SENIOR VICE PRESIDENT, OPPORTUNITY INTERNATIONAL

Ms. CHESTON. Mr. Chairman, I would like to thank you for your leadership in so many ways over so many years in remembering “the least of these” around the world through your support for microfinance, microenterprise programs, human rights programs, sex trafficking. Truly it is an honor to be asked to testify.

I would also like to thank Ranking Member Payne, who I know is so committed to microfinance and microenterprise and yet is currently en route to Africa. So I know of his intense interest in the subject, and I am grateful that he has asked me to testify.

On the Ides of March in 1992, I arrived in El Salvador, having just come from Costa Rica, with seven suitcases and boxes and a dream of serving the poor through microfinance. It was the single most transforming experience of my life. I had the opportunity to sit in dirt floor shacks made of corrugated metal with very poor women and learn about their dreams and learn about their hopes for the future and for their children. And in the context of that, I saw tremendous changes happening right in front of my eyes on a week-by-week basis. I would walk into a community and see that electricity had been strung up for the first time or that children were now going to school for the first time. I would see that people had moved from these dirt floor shacks into concrete block homes, and most of all, I saw women standing tall. With that experience, witnessing the power of a loan as small as $50, I learned the power of daring to think small.

And now as senior vice president for Opportunity International, my view is a bit broader and a bit bigger, but I hope not too big to forget that important lesson of thinking small. And as chair of the Microenterprise Coalition, I have learned a great deal about the explosive potential of microfinance that has been made possible through so many leading microenterprise organizations, networks such as ACCION, FINCA, Grameen, Save the Children, World Council of Credit Unions, MEDA, World Relief, World Vision and many others.

So based on this experience, I have a few key points to make, in fact four points.

First, public funds matter. USAID matters greatly in bringing about a financial services revolution for the poor. Ms. Schafer spoke wonderfully about the capital from private sources that has been attracted to microfinance, largely as a result of USAID's initial investments in this field and its global leadership in the industry over many years. And many of us in the industry are aggressively and successfully seeking private capital donations as well as investment capital, but still, there is an extraordinary opportunity right now for the U.S. Government through any number of entities, USAID, the State Department, Millennium Challenge Corporation, to play a leadership role in making this revolution a reality.

I will give my own organization as one example, I believe, of a cost-effective investment that has been made by USAID over the years. Over the past 12 years, USAID has contributed over $75 million in grant funding to 19 of Opportunity's partner institutions around the world. Those USAID-funded institutions alone now serve 275,000 clients, loan clients, as well as 60,000 voluntary savings clients. And they have financed 466,000 micro and small businesses. I did a little math and just counting the businesses financed and without taking into account the savings clients, that means an average cost per business financed of $161. What is remarkable is that funding is no longer needed for most of these institutions, but the work is continuing on. Today, these institutions operate at an average sustainability of 104 percent, which is what enables them to continue this growth without further funding, and they revolve a loan portfolio of $141 million. Over the years, the total loans made only for those of Opportunity's institutions that have received USAID funds is conservatively over $270 million. That seems to me an excellent return on USAID's investment of $75 million.

Public funds can play a significant role in building retail microfinance institutions that directly provide services to the poor and in promoting the kind of R&D that leads to groundbreaking innovation. For instance, Ms. Schafer mentioned our program in Malawi, which is one of the poorest countries in the world, as I am sure you know. There, USAID's investment in Opportunity International Bank Malawi has led to the development of smart cards. These are ATM cards with clients' biometric identification embedded on a chip. These cards allow illiterate people with no official government identification to participate in the banking system and in fact to open savings accounts as small as a $5 initial deposit. Other innovations again funded by USAID focus on bringing banking services for the first time to the rural poor in the most isolated parts of Malawi, innovations such as satellite branches, point-of-sale devices, ATMs, mobile banks and cell phone banking. Imagine that potential tapped on behalf of the poor. With this kind of track record of cost effectiveness, innovation and outreach, microfinance should not be a niche program. It should be thoughtfully considered as a key strategy crossing many objectives in the foreign assistance framework. Public funds matter.

Shall I continue?

Mr. SMITH. Yes, absolutely.

Ms. CHESTON. My second point is that microfinance is a key strategy for ensuring that the poor both contribute to and benefit from economic growth. A month ago, I attended a superb learning conference hosted by USAID's Office of Microenterprise Development, and during that conference, I learned about a study carried out by Erik Gartzke of Columbia University. Professor Gartzke found that economic freedom is about 50 times more effective than democracy in diminishing violent conflict. To be more exact, he said economic freedom is 54 times more effective than democracy in diminishing violent conflict. So, in other words, free markets appear to encourage peace, and the best foreign policy is one that enhances and extends capitalism. If you want peace and prosperity, you need economic freedom. But the question remains, how to ensure that poor people are included in economic growth.

Microfinance matters because it is a way for poor people to participate in growing the pie and then participate in the benefits of the bigger pie. How are USAID, the State Department and the Millennium Challenge Corporation ensuring that microfinance is part of their plans?

Third, microfinance and microenterprise can be powerful tools to achieve a range of foreign assistance objectives, and I was delighted by your question earlier about integrating these services into programs such as natural resource management, HIV/AIDS, malaria and the avian flu. I will just mention one of Opportunity's clients in Uganda who is affected, in fact infected, by HIV/AIDS. Evas Kalemeera had a thriving business raising chickens. AIDS struck her family with a vengeance; killed her sisters, her brother, four uncles, three of her husband's siblings and her husband and, most devastatingly, her 6-year-old daughter Margaret. HIV-positive, sick and bedridden, Evas lost her farm and her chicken-raising business. Yet as a mother, she realized she could not afford to give up on life, and with nowhere else to turn, she contacted Opportunity for a loan to start a new business. She was glad, she said, that Opportunity saw her as a living person and not as a walking corpse. Today, Evas operates a thriving maize flour business. She is able to pay school fees for her two remaining children and her orphaned niece as well as to feed them, and she is even able to cover the costs of ARVs from the income of her own business. Now, this is just one example of thousands of our clients who are helped to move forward with their lives living positively with HIV/AIDS.

Also through our Trust Bank Lending Groups, we are providing HIV/AIDS prevention and awareness training to our clients, mostly women who are hard to reach through more formal channels. We are adapting our financial services to meet the needs of those who are affected by HIV/AIDS. One example, in Zambia, we have a very popular funeral benefits product, an insurance product. The cost of funerals was completely wiping out our clients' livelihoods, and this funeral benefits insurance product has become the most popular product we have in that country. And of course, throughout sub-Saharan Africa, our microbusiness loans provide our clients with the means to care for AIDS orphans and those who are infected by HIV.

Is our foreign assistance strategy flexible enough to allow for microfinance and microenterprise programs to be integrated into objectives such as the ones you have identified earlier in your remarks?

Fourth and finally, USAID has created powerful incentives in the past that have led the microfinance industry to achieve large-scale outreach and financial sustainability. Now, thanks to the legislation that you sponsor, USAID has the opportunity to create incentives to ensure that the very poor and other unserved populations are included in the financial services revolution.

Now, I have perhaps a different take on this situation from my very esteemed colleague Gary Woller. My belief is that the investment to date in the development of poverty assessment tools will truly pay off when the focus becomes innovation in products and services to reach the very poor and all those who are still excluded from the world's financial systems. With the increasing sophistication and capacity of the microfinance industry and greater access, as we discussed, to private and social investment capital, the poor and the less poor are just more easily reached, and as you well know, the legislation does not require that 100 percent of funds go to the very poor but rather that 50 percent of the funds go to the very poor, leaving plenty of room for other poor and non-poor clients to be reached. It does seem to me that this is an appropriate use of public funds therefore to support innovation and product development, technology and institutional capacity building that will lead to reaching hard-to-reach populations. In other words, as we look at the role of public funds and private funds, since private funds are coming into the microfinance industry at such an extraordinary rate, it frees us up to use public funds to reach the very poor, those in rural areas, women who are among the most marginalized and who are an invisible market still in many developing countries, and the disabled.

For me, one of the most useful aspects of the poverty assessment tools currently under development is in fact what they can teach us about our clients so that we can figure out how best to serve the full range of clients from very poor to poor to the vulnerable non-poor. The other useful aspect is how these tools can spur us to innovate and encourage USAID to create incentives for innovation in reaching the unserved and underserved. Incentives can work wonders, as you well know.

Five years ago, USAID strongly encouraged its long-time microfinance grantees in Egypt to add a new poverty targeted group lending program targeted to women. Resources and incentives increased the percentage of women reached from 17 percent to 54 percent in just 2 years along with fueling spectacular growth in outreach.

So my question is, will USAID put its technical expertise and resources behind the cause of downreach and outreach to hard-to-reach populations through these kinds of incentives and through strategic guidance for its missions?

In closing, here is why I think microfinance has such potential. In 1991, after 20 years in business, Opportunity International had 6,000 clients. Today, only 15 years later, Opportunity has 850,000 clients, just loan clients, along with 3 million poor people who now have basic micro-insurance to protect them in the event of disaster or disease as well as many savings and remittance clients. That kind of exponential growth in numbers and range in services is found throughout our industry. Some would argue that microfinance is not enough, and it is certainly true that we need a range of services that reach all who are excluded from financial systems and markets and not only the very poor and poor. But that said, it is also true that there is not enough microfinance. Today, 30–50 million people, mostly women, have access to microfinance services, according to rough estimates. Yet 300–500 million people, again rough estimates but mostly women, are still excluded from basic financial services and yet could benefit from them. What it took to get us from zero to 50 million clients in just three and a half decades was the hard part. Expansion to reach 500 million has its challenges, but they can be overcome. This is a job we can finish in our lifetime. And once we have done it, it is done. With sufficient initial investment, a microfinance program can reach sustainability and, from then on, can continue to provide life-changing opportunities for the poor without further grant funding.

So my question is, will USAID, the State Department and the Millennium Challenge Corporation keep up with this revolution? Will they provide global leadership to ensure that microfinance achieves its potential? This is a job we can finish. With your help, Mr. Chairman, we can finish the job. Thank you very much.

[The prepared statement of Ms. Cheston follows:]

PREPARED STATEMENT OF MS. SUSY CHESTON, SENIOR VICE PRESIDENT, OPPORTUNITY INTERNATIONAL

Mr. Chairman, I would like to thank you for your leadership over the years in ensuring that "the least of these" thoughout the world can receive new hope and opportunity through microfinance and microenterprise programs. Thank you for your passion, commitment, and powerful concern for the world's most vulnerable. I would also like to thank Ranking Member Payne for inviting me to testify, and express my gratitude that he is so committed to microfinance and microenterprise that he is leaving straight from the hearing for the airport en route to Africa.

On the Ides of March in 1992, I arrived in El Salvador with 7 suitcases and a dream of serving the poor through microfinance. As director of the Women's Opportunity Fund of Opportunity International, I was given the most phenomenal opportunity of my life: to help make a difference in one small corner of the world. I say I was "director"—but I was also the secretary, messenger, and, most of all, loan officer. It was my privilege to spend my days meeting with very poor women, providing them with micro loans so they could invest in very small businesses, and then watching as week after week they began to take charge of their lives. Living and working among very poor women whose lives changed dramatically thanks to loans as small as $50, I learned the power of daring to think small.

Now, as Senior Vice President for Policy for Opportunity International, my view is a bit broader. And as Chair of the Microenterprise Coalition, I have learned a great deal about the explosive potential of microfinance that has been made possible through such leading organizations as ACCION International, CARE, FINCA International, Grameen Foundation, MEDA, ProMujer, Save the Children, World Council of Credit Unions, World Relief, and World Vision, among others.

Based on this experience, I have several key points I would like to make today:

1. Public funds matter. While many of us in the industry are aggressively seeking private donations and investment capital, there is an extraordinary opportunity for the U.S. Government to make an impact on economic growth and poverty if USAID, the State Department, the Millennium Challenge Corporation, and other entities play a leadership role in investing in microfinance.
2. Microfinance is a key strategy for ensuring that the poor both contribute to and benefit from economic growth.
3. Microfinance and microenterprise can be powerful tools to achieve a range of foreign assistance objectives, and can make a difference when integrated not only into economic growth objectives, but also into programs such as HIV/AIDS, natural resource management, malaria, and avian flu.
4. USAID has created powerful incentives in the past that have led the microfinance industry to achieve large-scale outreach and financial sustainability. Now, USAID has the opportunity to create incentives to ensure that the very poor and other unserved populations are included in the financial services revolution. The investment to date in the development of poverty assessment tools will truly pay off when the focus becomes innovation in products and services to reach the very poor and others who are still excluded from the world's financial systems.

A BIG VISION FOR THE FUTURE OF MICROFINANCE

Here's why I think microfinance has such potential. In 1991, after 20 years in business, Opportunity International had 6,000 clients. Today, only 15 years later, Opportunity has 850,000 loan clients, along with 3 million poor people who now have basic micro insurance to protect them in the event of disaster or disease, plus a growing number of savings and remittance clients. That kind of exponential growth in numbers and in range of services is found throughout our industry.

Some would argue that microfinance is not enough—and it's certainly true that we need a range of services that reach all who are excluded from financial systems and markets, and not only the very poor and poor. But that said, it's also true that there is not enough microfinance.

Thirty to fifty million people today—mostly women—have access to microfinance services—yet 300 to 500 million people—mostly women—are still excluded from basic financial services and yet could benefit from them. What it took to get us from 0 to 50 million clients in just 3 and a half decades was the hard part. Expansion to reach 500 million has its challenges, but they can be overcome. This is a job we can finish in our lifetime. And once we've done it, it's done. With sufficient initial investment, a microfinance program can reach sustainability, and from then on can continue to provide life-changing opportunities for the poor without further grant funding.

Will USAID, the State Department and the Millennium Challenge Corporation keep up with this revolution? Will they provide global leadership to ensure that microfinance achieves its potential?

THE IMPACT OF PUBLIC FUNDS: THE CASE OF OPPORTUNITY INTERNATIONAL

Much of what we've accomplished as an industry has been made possible through appropriate use of public funds—which, in Opportunity's case, have been leveraged through significant private support. Over the last 12 years, USAID has contributed over $75 million in grant funding to 19 Opportunity International institutions around the world. These USAID-funded institutions now serve 275,000 loan and 60,000 voluntary savings clients and have financed approximately 466,000 micro and small businesses. Just counting the businesses financed and without taking into account savings clients, that means an average cost per business financed of $161. What's remarkable is that USAID funding is no longer needed for most of these institutions, but the work goes on. Today, these institutions operate at an average sustainability of 104% and revolve a loan portfolio of $141 million. Over the years, the total loans made, only for those of Opportunity's institutions that have received USAID funds, is conservatively over $270 million. That seems to me an excellent return on USAID's $75 million investment.

Further, Opportunity continues to leverage private funds with public funds and vice versa. In 2005, Opportunity International received $7 million in USAID funds and $23 million in support from private donors. In addition, we placed $50 million in debt, primarily from social investment funds. As a global network, we are leveraged one to one, and our leverage is growing.

USAID'S IMPACT: OPPORTUNITY INTERNATIONAL BANK MALAWI

Here's a specific example of the impact of USAID funds on Opportunity's work in Africa. In Malawi, one of the world's poorest countries, Opportunity's bank is a beacon for the poor. With USAID's help, Opportunity International Bank Malawi (OIBM), or "My Bank" as it's called by customers, is aggressively expanding throughout the country, including reaching the most remote rural areas with financial services using innovative products and technology. As of March 2006, OIBM was serving 5,443 loan and 39,323 savings clients with an arrears rate (>30 days) of just 1.58%.

In 2003, USAID awarded Opportunity International $2,160,918 to build the institutional capacity and outreach of its newly created microfinance bank in Malawi—OIBM—which obtained its banking license from the Central Bank in March 2002. In partnership with USAID, Opportunity has pioneered a scalable, technology-driven, low-cost approach to providing a full range of financial services to poor families living in rural Malawi.

OIBM's innovative approach includes Smart cards—ATM cards with clients' biometric identification embedded on a chip. These cards allow illiterate people with no official government identification to participate in the banking system. Other innovations include satellite branches, Point-of-Sale devices, ATMs and mobile banks that bring banking services for the first time to the rural poor in Malawi.

Opportunity has also innovated in the products it offers. Small groundnut farmers were unable to get credit from the local banks because of the high risk of drought. The World Bank contracted with Opportunity to develop a drought insurance product, and now all farmers who have purchased drought insurance are eligible for loans that are enabling them to buy higher quality seeds that have higher yields and greater disease resistance.

Building on USAID's investment, since 2003, Opportunity OIBM has secured debt and equity financing totaling $4,244,645 and has mobilized deposits of more than $3 million.

For poor people in Malawi, USAID's investment has been life-changing. Under the State Department's new foreign assistance framework, will this kind of investment continue?

THE STATE DEPARTMENT'S STRATEGY

Many of us in the microfinance community have been impressed by Ambassador Tobias's focus on measurable results and on developing coherent country strategies that do not duplicate efforts but rather ensure that all the entities of the U.S. government work together effectively on diplomatic and development goals. Yet we have questions about where economic growth and poverty alleviation will fit into the mix.

A month ago, I attended a superb Learning Conference hosted by USAID's Office of Microenterprise Development. During that conference, I learned some fascinating things about both economic growth and poverty alleviation.

ECONOMIC FREEDOM AND PEACE

In 2005, a professor from Columbia University, Erik Gartzke, did a statistical study to determine what variables lead to conflict between countries. He looked at military action correlated with such factors as economic freedom, population, democracy, total land area, arable land, and status as a major power. Professor Gartzke found that "economic freedom is about 50 times more effective than democracy in diminishing violent conflict." To be more exact, he said "economic freedom is 54 times more effective than democracy in diminishing violent conflict." In other words, "free markets appear to encourage peace" and "the best foreign policy is one that enhances and extends capitalism." If you want peace and prosperity, you need economic freedom.

ECONOMIC GROWTH AND POVERTY ALLEVIATION

There's been a raging debate at the World Bank and within the U.S. Government about economic growth versus poverty reduction strategies—basically, which comes first. After a rigorous statistical analysis of different countries' poverty and economic growth trends, two leading economists at the World Bank, Humberto Lopez and William F. Maloney, released a report this year called "Poverty Reduction and Growth: Virtuous and Vicious Circles." They confirm what many have concluded, which is that you can have economic growth without poverty reduction, but you can't reduce poverty without economic growth. The idea is that a country can grow economically without reducing poverty—in fact, in such a way that the rich get richer and the poor get poorer. But if you're trying to reduce poverty, so-called poverty alleviation programs are simply not enough. If the pie is too small, even if you divide it equitably, you still won't have enough pie to go around. You have to grow the pie.

Microfinance matters because it is a way to grow the pie in a way that poor people can benefit. Actually, that's not quite right. Microfinance matters because it is a way for poor people to participate in growing the pie—and then participate in the benefits of the bigger pie.

How are USAID, the State Department and the Millennium Challenge Corporation ensuring that microfinance is part of their plans?

SMALL LOANS, BIG IMPACT: THE STORY OF EVAS

One poor woman who is doing her part is Evas Kalemeera. One of Opportunity's clients in Uganda, Evas had a thriving business raising chickens. But then, in 1999, her six-year-old daughter Margaret died of AIDS, and Evas and her husband learned they were HIV positive.

Soon, Evas became too sick and depressed to work and was bed ridden. The farm was lost. In August of 2000, her husband died as a result of AIDS. Evas struggled to care for her two remaining children and an orphan who had belonged to her sister who died of AIDS. AIDS had also taken the life of her brother, four uncles, and three siblings from her husband's side.

Yet as a mother she realized she could not afford to give up on life. With nowhere else to turn, Evas contacted Opportunity for a loan to start a new business. She was glad that Opportunity saw her as a living person and not a walking corpse like so many others did. Today, on her third loan cycle since her illness, Evas operates a thriving maize flour business with many customers.

Evas says, "These loans have . . . boosted my business and I am able to fend for my children and myself . . . paying school fees, feeding and attending to my medical requirements." She has even been able to pay for antiretroviral drug therapy to extend her life. Evas refers to her Trust Bank as her parents, her husband, and her support.

MICROFINANCE AND HIV/AIDS

The story of Evas highlights the importance of recognizing the potential for microfinance and microenterprise programs to interact with other programs such as natural resource management, AIDS, avian flu and malaria. In the case of AIDS, Opportunity is proud to have received an award in the first tranche of PEPFAR. We are not a health or AIDS organization and we are not trying to be. However, we have found that, as a microfinance organization, we can use our infrastructure to provide prevention and awareness training to our clients—mostly women who are hard to reach through other more formal channels. We have also found that people who are affected by HIV/AIDS can benefit tremendously when we adapt our financial services to meet their needs. In Zambia, our clients' livelihoods were wiped out whenever there was a death in the family due to the high cost of funerals. We developed a funeral benefits insurance product called Ntula that has become perhaps the most valued service we provide there. And throughout sub-Saharan Africa, our micro business loans provide our clients with the means to care for AIDS orphans and to care for those who are infected.

Is our foreign assistance strategy flexible enough to allow for microfinance and microenterprise programs to be integrated into objectives such as the fight against AIDS?

TARGETING THE POOR AND VERY POOR: THE ROLE OF POVERTY ASSESSMENT TOOLS

In 2003, Congress gave USAID a strong directive to focus at least half of its microfinance and microenterprise funds on reaching the very poor. PL108–31, the 2003 amendment to the Foreign Assistance Act, required the development of poverty assessment tools in order to measure USAID's success in achieving that mandate. In my view, USAID has sought to carry out the congressional directive with energy and intelligence, modeling a positive collaborative approach with the practitioner community. As expected, there have been glitches in the development and certification of poverty assessment tools, despite best efforts on all sides. My concern is that in the midst of the technical challenges of developing and now implementing the tools, the basic principle behind their development will be lost. Quite simply, we want to make sure that those who are excluded from financial services are not left out going forward.

It is naturally easiest to provide services to those who are better off in any society. Likewise, it is easier to provide services to those who are "poor" than to those who are "very poor". The beauty of financially sustainable institutions is that, once costs are fully covered by interest rates and loan fees, we no longer have to choose from among deserving clients. In the early days, we were often faced with a choice of giving a $1000 loan to one client or $100 loans to 10 clients—or, for that matter, $50 loans to 20 clients. Under those circumstances, I would always argue for reaching the poorest clients we possibly could. Now, however, once a microfinance institution is fully sustainable, it can fund its growth through borrowed funds. Assuming we develop the human and technological capacity—which is a great challenge for us all and one I don't mean to treat lightly—we can then provide a loan both to the $1000 client and to ten $100 clients, without needing to make draconian choices.

An organization that sets itself up with a poverty focus and intentionally tries to push the envelope to reach a lower level of poverty is likely to be able to grow with its clients and meet their growing capital needs over time, as well as to expand into easier-to-reach markets. Conversely, an organization that targets the poor and not-so-poor, as opposed to the very poor, is less likely to discover the market of the very poor and figure out how to serve it without some kind of specific intervention. Look at the history of banking around the world over time: there are not a lot of examples of downreach to reach the poor and very poor among mainstream banks, which is why the microfinance field developed in the first place.

PUBLIC FUNDS TO PROMOTE DOWNREACH AND INNOVATION

This brings me back to the question of the appropriate use of public funds for microfinance. With the increasing sophistication and capacity of the microfinance industry and greater access to private and social investment capital, the poor and less poor are more easily being served. It seems to me that it is an appropriate use of public funds, therefore, to support innovation in product development, technology, and institutional capacity-building that will lead to reaching hard-to-reach populations. This includes the very poor, those in rural areas, marginalized women, the disabled, and other unserved populations. For me one of the most useful aspects of the poverty assessment tools currently under development is what they can teach us about our clients so that we can figure out how best to serve the full range of clients, from very poor to poor to the vulnerable non-poor. The other useful aspect is how these tools can spur us to innovate—and encourage USAID to create incentives for innovation—in reaching the unserved and underserved.

Incentives can work wonders. Let me give one example of USAID providing incentives in a way that successfully encouraged downreach, including a greater focus on unserved women. According to a USAID report in fiscal year (FY) 2000, six Egyptian microfinance institutions reported a total of 72,634 clients, with an average loan size of $506. Only 17 percent of these clients were women. In FY 2002, these same institutions reported 115,345 clients (a growth of 59 percent) with an average loan size of $372 and that 54 percent of these clients were women. The secret? The USAID Mission strongly encouraged its long-time grantees to add a new group-lending product specifically designed for women, which now accounts for virtually all of their growth.

Will USAID put its technical expertise and resources behind the cause of downreach and outreach to hard-to-reach populations through these kinds of incentives and through strategic guidance for its missions?

PRESERVING THE SOCIAL MISSION

In closing, I agree with my colleague Gary Woller that the development of tools to measure and manage social performance and the encouragement of greater transparency are keys to ensuring that the social mission of microfinance is not lost in the increasing trends toward commercialization and large-scale growth. I commend USAID for its efforts to fund the research and development of these tools. This is the kind of innovation that will ensure that microfinance achieves its promise on behalf of the world's poor. With this kind of leadership, together with a healthy, collaborative relationship with the practitioner organizations that provide direct services to the poor, this very small idea—this micro idea—turns out to be a very big idea after all.

Mr. SMITH. Ms. Cheston, thank you very much, and thank you for your extraordinary leadership which has been noted not only by me, but by Members on both sides of the aisle. It has been extraordinary.

Regrettably, we have another vote underway on the Floor followed by a whole series of votes, and I do not want to keep you here until 5 o'clock or 6 o'clock. So I will ask some questions, keep the record open, and we will submit some questions for the record as well. I apologize again for having to run off, but there is a whole series of votes; it isn't just one vote.

I would ask, first of all, about the idea of targeting the poorest of the poor, the very poor, I should say. The USAID report points out that only 23 percent of the funding reached those individuals. Any suggestions you might have on how we can beef that up?

I know, Dr. Woller, that you take—while you are not against it, obviously, reaching the poor, you have some different thoughts. I thought you might want to speak to that. What studies—and, Dr. Woller, this could be a question to you—have been conducted, and what were their findings regarding how and to what extent microfinance has led to sustainability? What have been the intermediate and longer-term consequences of microfinance, particularly the loans to start a business? Has that been tracked?

The issue of conflict and national disasters, I know because I met with a lot of the Kosovar refugees during the Kosovo crisis. I went to the refugee camps, and I know GAO cited in its report that the USAID microfinance assistance isn't necessarily helpful in that kind of disaster, yet we saw with the tsunami that it was. Now, does that have to do with refugee flows in populations or is it—you know, how can we do a better job? Should we be doing a better job with regard to conflict and natural disasters? The whole issue of central bureau versus mission assistance, where best is that money allocated? Do we have the right balance currently?

I do have a lot of questions. I have only 2 minutes, regrettably. If you could speak to those issues, I would appreciate it. And then we will submit some written requests for the record. Without objection, when you are concluded with your answers, the hearing will be adjourned. Thank you.

And again, I apologize.

Ms. CHESTON. With respect to the question of USAID reaching the very poor and the 23 percent figure in their report, I would say that one of the benefits of the Microenterprise Results and Accountability Act of 2004 is pushing for more information, more transparency in those kinds of figures, and USAID has very wonderfully complied through its most recent report. With the development of poverty assessment tools, we will now be able to get much better information about what is, in fact, going on in terms of reaching the very poor and with incentives such as the Implementing Grant Program (IGP) that Ms. Schafer referred to. We will now have a much better idea of how we can start transforming our understanding of what level of poverty we are reaching, in order to encourage innovation in downreach. So I would say that that 23 percent figure is an important one to acknowledge and understand, and that by the next fiscal year and the fiscal year beyond that, we should be showing improvement in that percentage, and that the law is doing its part in ensuring that that will happen. And I would like to acknowledge that USAID's work on poverty assessment tool development has occurred with great energy and intelligence and has made a great contribution to that issue.

Mr. WOLLER. Right. I would just like to briefly address something she just addressed on the 23 percent. First of all, the 23 percent, if I remember—I don't know the 2005 figures—but, in 2004, was a similarly overall low figure, and it was driven by a very low figure of very poor outreach among enterprise support programs, not lending programs but enterprise support programs. So I am assuming it is a similar thing in the most recent report, what is going on, and I would just reiterate that I think that figures are virtually worthless because the enterprise support programs have absolutely no clue what the poverty status of their clients are. As I said, a complete stab in the dark. I consider that figure to have very little value.

But let's assume for a second it has some value. I think what we might be observing among the enterprise support programs is that these programs again are trying to, I think, I am guessing, support private sector development, and my guess is, and having worked with a few of them, their thinking on that is, the best way to promote growth is not necessarily to target your innovations down at the very poorest but target perhaps somewhere further up the value chain, and they are thinking in terms of creating dynamic growth businesses sometimes, not necessarily funding the small trading, petty trading and service-type enterprises which commonly benefit from lending programs. So in a way, you are comparing apples and oranges, and frankly, I wouldn't mix the two. I would look at them separately because they are separate things sometimes with very separate and distinct objectives, and I think you need to take that into account.

Now, in terms of the impact assessment, what is the impact in microfinance, I mean there have been literally over a hundred impact studies that have been done in microfinance, and I myself in one study for the OECD looked at almost 90 of them. And there are others. And now the thing to keep in mind when looking at these studies, they are of a wide variety of quality, and I wouldn't recommend the results as being valid in every case. And yet you see some patterns, and one of the patterns that you see is the impact in microfinance is very specific to the context. It is very hard to generalize that microfinance has this impact or that impact. I think the best you can say is, depending on the context, it may or may not have this impact. But I mean, the quality of the program, the types of products and services it is offering, whether it is meeting the needs of the marketplace, the external economic and political environment, there is a whole host of factors which vary significantly from country to country, region to region, will determine what those impacts are, and there is a whole host of other things down at the microlevel including what is going on in the local society, power relationships within society, access to markets. I mean, any number of things which will determine what impact a program has. So it is really hard to generalize. I think that if you talk to people who look at these studies, what they will conclude, and maybe Susy has some other insight than I do, is that, yes, overall there is a positive impact.

Yes. There is overall positive impact out of the studies, and one of the positive impacts that is very important in lending to a lot of these women and others is, it gives them another means by which to sort of manage risk and cash flows that become part of household overall livelihood and coping strategy and become a very effective tool in helping households manage in their risky lives where they are necessarily growing their businesses.

My guess is, they are not. This is not budding Bill Gates. These are women who are trying to build a little extra income into their households. And so the impacts are varied, but they are there, and I think they are significant. And I think in my own mind the information—the preponderance of evidence is such that we can conclude with a high level of confidence that microfinance does have a significant impact on improving the well-being of those who benefit from it.

Now, whether it is lifting them en masse out of poverty, I don't know. I am a bit skeptical about that claim, but I am willing to be convinced.

Mr. MWANGI-KIOI. I wanted to add just a word on the impact. We have a progress-out-of-poverty index that we have developed which is being actually tested in some of our partners' institutions. This is a 10-point measurement, too, and it measures 10 indicators; and when the 10 indicators are satisfied as the client progresses from loan after loan within the program, it is possible to measure that they have crossed the poverty line. And this is under test and we are hoping that it will be available generally for microfinance institutions as a tool, as a measurement to assess the progress out of poverty for their poor clients.

Ms. NAGY [presiding]. Any comments?

Ms. CHESTON. In response to the Chairman's other questions about central versus mission assistance, for instance, the Microenterprise Accountability Act in 2004 specified at least $25 million appropriated should go to the central office of Microenterprise Development. For, I believe, 3 years in a row the appropriations process has resulted in a recommendation that at least $30 million of the funds appropriate for microenterprise and microfinance would go to that central office for central funding.

And, in particular, although the appropriations report noted the importance of preserving the viability of the leading microfinance networks, what I understand from the report that has just been relayed by USAID is that $17 million was allocated to that central office of Microfinance Development and then another $5 million was available through the private voluntary corporation office, which has had an invaluable matching grant program that has been much appreciated and important in growing the capacity of microfinance institutions around the world.

So, to our view, USAID has not been able to meet its commitment according to the law to fund the budget of that office. The issue is that microfinance and microenterprise are very highly technical fields.

There is a really superb technical team at the office of Microenterprise Development, but it would be unreasonable to expect that every single USAID mission around the world would have that level of technical expertise in such a specialized subject area, especially one that has been evolving so rapidly and in which global best practices are constantly being ratcheted up so that what was considered global best practice 2 years ago is now considered pro forma and we are constantly trying to raise the bar higher on performance on behalf of the poor.

So in that light, it is important for there to be a level of technical expertise. As well, there is an issue of making global and regional funding vehicles available. One of the reasons USAID has been so successful over the years in developing microfinance to the level it has achieved is that it has invested heavily in market leaders who have been developed by the leading microfinance networks. Those are global networks that have economies of scale that they can achieve and that have the potential for sharing best practices across their organizations as well as technology advances, et cetera. And in order to allow those kinds of economies of scale and market leadership to continue as the networks have done in the past, it is important to have funding vehicles that are global and regional and not strictly country by country.

I would also say that it is important in the state restructuring and in the new assistance framework to make sure that microfinance and microenterprise are fully understood and taken advantage of as an important strategy that can cut across a number of different goals and objectives. And part of my concern is that with a country-by-country strategy, again there may not be sufficient expertise to look at something that is essentially banking and finance within each country and that, because this is seen as often a niche market or niche program, it may not be given the attention that it deserves in order to have the benefit that it can provide to the world's poor.

And I guess the other comment I would like to make about that issue of central versus mission assistance is that there is not one entity globally that is providing leadership to look at the demand for microfinance services around the world, where we are as an industry and how we can fully achieve this revolution so that all the world's poor can receive services, including those who are currently excluded.

In other words, we have achieved a drop in the bucket up until now with our microfinance programs if we are reaching 30–50 million, but we have tremendous capacity to reach so many more.

I think it would be very exciting for USAID and the State Department to take on the challenge of establishing that vision and drawing on the significant players within the industry, within the practitioner community, within the funding community, within the private donor and social investment community and to rally forces to see how we can remove the constraints to achieving microfinance potential not just with funding, but also other kinds of regulatory issues, et cetera.

So a central office that is thriving and healthy and able to make its mark on the USAID mission and is able to make its mark on the State Department would be of great use in that kind of vision-setting activity.

Mr. WOLLER. I just—I have been making notes here and want to back up here a bit because I have some thoughts on the first question of how to reach, or how to increase this figure, other than my criticism of the metric that is used to measure it.

Go back to the recommendation I made earlier: How do we increase this? Well, over time, I think the way you increase it is by providing some kind of incentives for organizations to target rural areas. And when I say "rural areas," I don't mean setting up a village banking group in a rural area and funding women to trade in underwear and shops. I am talking about farming and agribusiness and the types of activities that are usually in rural communities.

Microfinance has made significant, I think, steps in reaching low-income people or those who didn't have access to financial services before. It has done very well in impaired urban areas, and it has not figured out how to do it in rural areas.

Let me give you an example. I was just in Bolivia a couple of months ago working with an organization there, and it is one of the poster children of microfinance success. If you look at it, there are two or three institutions that make any kind of effort to serve rural areas. We were working with one of them and, of those, it was actually trying to make loans to farmers and to fund agribusinesses, but it was coming under pressure because its financial performance was lagging behind even though it has relied solely on donor funding. It wasn't accessing private funding.

So they came up with a strategy as they were going to move into the urban areas, and they had—part of their industry was to provide higher rapid business turnovers, the kind that are funded by microfinance programs. There were external pressures on them to move out of ag lending, not because it is bad, but to say you have got to be substantially financially self-sufficient. It was driving them out of this market to a certain extent.

So I think not only do we need to come up with sort of innovative approaches to do rural lending, but we also need to create incentives so that institutions can go in there and feel confident that they can experience and innovate, and do so and not be under pressure to yield a financial self-sufficiency in a 4- to 5-year period. And there can't be obstacles; there have to be carrots.

The other thing, as well—I skipped over this part in my written testimony, so I can come back to get that. Why the focus on the very poor? Why not the poor? Why are we not interested in the tens of millions of people who don't fall under the poor line, but who are nonetheless poor? Someone who makes $1.10 a day by international standards is not terribly different from someone making 98 cents a day.

And so, I hear—like, I just listened to Susy; she was saying that she was referring to all the world's poor. You know, does she mean "poor" or "very poor," or what does she mean when she says "poor"?

I think that—in my mind, it is unfortunate the focus is on the "very poor." I think it ought to be broadened to the poor.

If, in fact, we are going to be talking about targets and encouraging institutions to reach down, I understand why you say "very poor." You want to incentivize them to go down. But there are trade-offs. A trade-off is that by pushing the very poor, you are going to be cutting a lot of institutions out of the loop, institutions that would be interested in targeting a poor market are maybe the more commercial institutions, or maybe others, but who do not find the very poor market attractive, not because they don't care about poverty but because of their business model; it doesn't work for their business model, but who would be highly capable of receiving large numbers of poor people either those below the poverty line or clustering above it.

I think that you know the industry would be better off to sort of let go of—I don't want to call it an "obsession," but let go of the insistence on the poorest of the poor. I think that rhetoric has got us to the point where I believe it is leading—you know, I don't believe it is productive.

I think we need to recognize that there are tens of millions of people out there who, by our standards, have very poor standards of living, who are very deserving, who could use financial services, but may not be below that very poor line. And I am not sure that by saying, Well, you know, we are not going to worry so much about you; not that we are saying, we are not going to serve you.

I just think that if you sort of change the definitions and expand your reach to the poor, I think, quite frankly, not only will your figures improve, but I think you will bring more people into your net, more institutions that will be willing to work with you to achieve that goal.

Mr. MWANGI-KIOI. I would like to touch on the issue of conflict. The Chairman mentioned 8 years, transitioning out of conflict. I would think that microfinance does have a place in those institutions, in those countries, because people who are coming out of conflict usually do not have jobs. But if microfinance comes in, it gives them an opportunity of borrowing a little money and being able to utilize that in setting up some income-generating activity. So I believe there is room for microfinancing in conflict areas.

As for natural disasters, we saw in the—with the tsunami in December 2004 in Asia many institutions did go into that region and set up small microfinance enterprises and institutions that were able to help the people restore their livelihood.

And we at Grameen Foundation do have a program, in fact, that is currently operating in the tsunami region; and the people there are very grateful for the opportunity to be able to get that opportunity of setting up and being able to generate some income and restore some form of acceptable livelihood.

Ms. CHESTON. I would also like to respond to the question on conflict and natural disaster; and primarily to thank the Chairman for bringing that question to the table, particularly because it is an example of the kind of thinking that we need to be doing across the board about microfinance. And I would just suggest that microfinance and microenterprise need to be part of any checklist in addressing particular country issues, whether it is post-conflict or a disaster situation, or as we have already discussed, natural resources management, AIDS, malaria, avian flu.

The avian flu example is obviously a pending one, rather than an active one, but in speaking with officials who are very engaged in that whole issue, they have recognized that it is going to be impossible to manage that crisis. If we are asking people to destroy their livelihoods, particularly for those who are raising chickens, perhaps 10 chickens and that is their whole means of economic income, how can we ask them to wipe out their livelihoods because of health concerns?

It simply is not a reasonable expectation, and that is going to lead to people protecting their assets and going into black markets, et cetera, and causing a hiddenness in this situation that—or lack of transparency that would be further damaging to the public health concerns.

So that is one example of something that might not have been anticipated, and yet bringing up that question, as Joe has done about livelihoods, points to microfinance as one way that people can be assisted to get back on their feet if they are required to destroy their chickens, for instance.

I would also like to point out that there has been evidence in the context of drought conditions in Ethiopia, as the result of a very rigorous study Gary has talked about—a number of studies are not so rigorous, but this was a very well done study with control groups, et cetera.

So in a World Vision program in Ethiopia, they found a significant difference between the nutritional quality of households where people were microfinance clients as opposed to those who were not. They found better diets among those children, and interesting to me, they found a significantly reduced need for food aid. That finding particularly, I should mention, was among female clients and did not hold true for male clients, which was one interesting side finding of this research.

But it does bring to mind the question, if we could implement sustainable microfinance programs which, by their very definition, are cost effective in situations of natural disaster, and at the same time, reduce the need for food aid, why would we not be much more aggressive about considering that as a significant strategy when faced with these kinds of situations?

I can't resist making one final comment before we are done.

The whole question about "poor" and "very poor" does get to be a question of language often. But I think the question of how are we able to reach those who are excluded, is perhaps another way to look at it, because there are a number of people who are vulnerable non-poor, who are excluded from the world's financial systems, and they should not be excluded.

Likewise, the emphasis that I thought Gary very helpfully brought up earlier in his remarks about focusing more on women and more attention on rural areas is very much to the point. And certainly more incentives from USAID in reaching women and the rural poor would be very helpful in encouraging the industry to move toward more innovation in that direction.

And then finally I would just like to say that it is a lot easier to go up than down. I remember—well, once a client has entered the door and is a poor client, a very poor client, it is easier to work with that client over time and help them grow their business and grow in their use of financial services, grow in income and to develop more sophisticated products and services than it is to start with a business model that requires reaching a higher level, when the challenge is to even recognize what is usually an invisible market of the poor and the very poor around the world.

And so it is not a question of either/or. I would say one of the great things about the sustainability of microfinance is, it does enable us to reach many people and not to have to choose. We are no longer in the situation we were in when I started in the business, which is, you had to choose between one $1,000 loan or $100 loans to 10 people or $50 loans to 20 people. We were forced to make those choices then. Under those circumstances, I would always say choose reaching the very poor, choose the $50 loans.

But fortunately, because of sustainability, we don't have to choose; and we find that a strong institution is often one that has a range of services across the board at many levels.

So the question is, to my mind, more specifically, what is an appropriate use of public funds given that so much private capital and investment capital is coming into the market? That funding, I think, can best be reserved for the easier-to-reach populations where financial sustainability and cost effectiveness are more easily achieved.

And so public funds, I think, are very appropriately used to incentivize organizations to reach farther down. I found that within my own organization, USAID funding of our programs to reach rural populations has been very important in encouraging our innovations.

So those are my closing comments on that area.

Mr. WOLLER. Not to make this go any longer, even though that is precisely what I am going to do, just for a second.

I just want to say, I agree with her that, in my mind, as we move forward in microfinance, we begin to tap into commercial markets. Increasingly, the role of public funding should be to fund experimentation, and the frontier of experimentation—sort of the "final frontier," if you want to use that cliche—is going down further, particularly in rural areas and maintaining the commitment to women, of course, finding ways to reach people who haven't been reached.

I wouldn't argue that you should use all public funding for that. I think there is a big role in public funding to help transition people into the capital markets. And in my mind, as well, you hear a lot about institutions tapping into capital markets. There is, for example, a big hullabaloo about Compartamos in Mexico, who did a bond issue. Hurray.

Well, that is a commercial bank. They have been doing that for hundreds of years. I didn't see that as a huge event.

In my mind, what would be really interesting is if you could figure out a way—most of the private funding is going to sort of a very small cadre of high-profile, highly financially self-sufficient institutions. But underneath that there is a layer of MFIs that are flying under the radar boats. They are very good candidates for private funding.

Another use of public funding would be to get this core—and a lot of these won't be commercial banks; some of them will be other types of institutional models to get this group into the capital markets, as well, that don't have the same publicity, that are kind of flying under the radar.

In my mind, that would be a really good use of public funds, as well, to try to transition those further up; and maybe continue that process as we continue to bring more up. But continue to have a very strong commitment to those institutions that are working with the more marginal, hard-to-reach populations.

Mr. MWANGI-KIOI. As a concluding remark, I support what Susy is saying about public funds being used for reaching and enabling institutions that do not have—cannot borrow commercial funds. I would say that those institutions that need that kind of funding abound in Africa. There are many institutions that are not yet sustainable in Africa, and they are trying to serve the population that we are saying need support.

So I think there is a lot of scope for USAID funds to be allocated for institutions like that, that are reaching the poor, that do not have access to any kind of funding, to enable them to at least improve their standards.

Ms. NAGY. Thank you, everyone. The comments here will be made part of the record, and the Subcommittee will also be submitting additional questions that Members have for you. We thank you very much for the good discussion.

The hearing is adjourned.

[Whereupon, at 4:40 p.m., the Subcommittee was adjourned.]

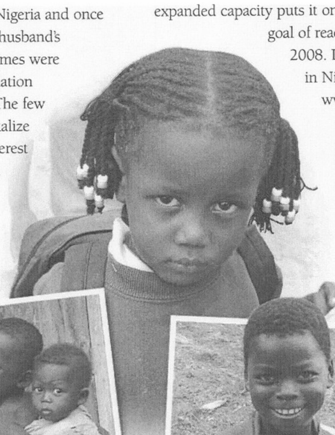
A P P E N D I X

Material Submitted for the Hearing Record

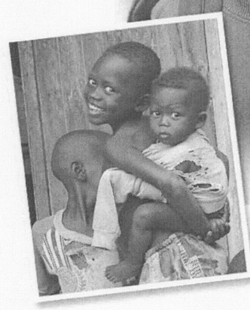
Nigeria Partner Gives Hope to More than 40,000 in Need

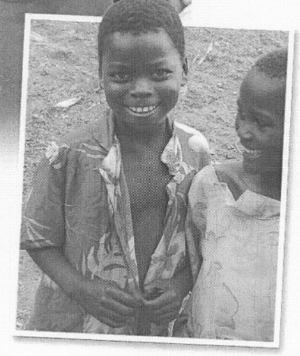
Mrs. Eje Okpu lives in Umunede, Nigeria and once struggled to feed her family. Her husband's business was faltering, and their hard times were compounded by the country's hyperinflation and economic recession in the 1980s. The few local moneylenders willing to help revitalize their business demanded exorbitant interest rates. Eje was losing hope until a friend introduced her to one of GFUSA's microfinance institution partners, Lift Above Poverty Organization (LAPO). Eje received a collateral-free loan from LAPO and now earns 5,000 Naira per day selling palm oil. Her market includes not just Umunede, but neighboring Igbodo, Oyoko, and Ogwashi-uku. She hopes to buy oil-milling machines to continue expanding her success.

LAPO was serving 43,747 borrowers like Eje as of December 2005. One of Nigeria's largest microfinance institutions, its growth and success are due in part to a 3-year, $1.3 million grant from USAID managed by GFUSA. The grant began in 2003 with the aim of strengthening LAPO's operations and increasing outreach. After three years, GFUSA's technical assistance and loan capital have helped improve LAPO's financial controls, reduce delinquency rates, implement automated MIS at all of its branches, and foster timely and accurate reporting. LAPO's transformation and expanded capacity puts it on a solid trajectory to meet a goal of reaching 225,560 clients by 2008. Learn more about our work in Nigeria with LAPO at www.gfusa.org/nigeria



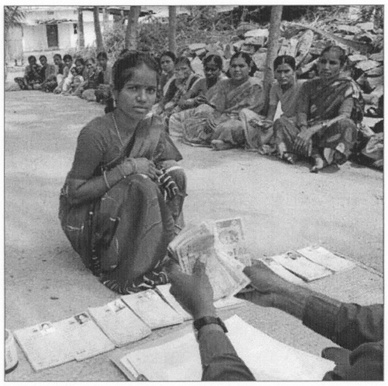
With technical assistance from GFUSA, LAPO staff have done tremendous work to serve nearly 44,000 borrowers as of December 2005.





Benchmarks before and after the USAID grant.

Benchmarks	Start of grant (Dec 2002)	Grant ending (Dec 2005)	Change
Gross Loans Outstanding (USD)	868,245	3,413,215	293%
No. of Loans Outstanding (# of borrowers)	18,740	43,747	133%



Grameen Foundation USA

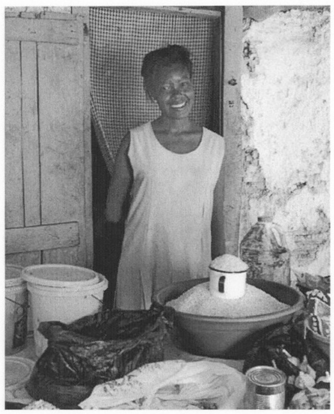
Measuring the Impact of Microfinance: Taking Stock of What We Know

by Nathanael Goldberg

December 2005

Grameen Foundation USA Publication Series

Executive Summary



The prevalence of microfinance impact evaluations has increased in recent years, with programs using studies not just to prove the effectiveness of microfinance, but to improve it as well. However, the quality and rigor of microfinance impact evaluations vary greatly. This paper surveys the most significant microfinance impact evaluations that have been published as of mid-2005 and guides readers through interpreting the results and reliability of each study.

One of the first comprehensive microfinance impact assessments was **"Credit for the Alleviation of Rural Poverty: The Grameen Bank in Bangladesh," (1988)** by Mahabub Hossain. Hossain found Grameen members' average household income to be 43 percent higher than target non-participants in comparison villages, with the increase in income from Grameen highest for the landless, followed by marginal landowners. Hossain warned it was likely that his impact findings would be overstated, however, because Grameen members were found to be younger and better educated than non-members who were more likely to be landless. This type of difference between participants and comparison households is prevalent among microfinance impact evaluations and limits the conclusions we can draw from many of them.

The 1998 book, ***Fighting Poverty with Microcredit*** by World Bank economist Shahidur Khandker, and the related paper, **"The Impact of Group-Based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter?"** by Khandker and Mark Pitt, a Brown University economist, were influential because they were the first serious attempt to use statistical methods to generate a truly accurate assessment of the impact of microfinance among three Bangladeshi programs: Grameen Bank, BRAC, and RD-12. The centerpiece of their findings was that every additional taka lent to a woman adds an additional 0.18 taka to annual household expenditures—an 18 percent return to income from borrowing. However, NYU economist Jonathan Morduch responded with the paper, **"Does Microfinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh" (1998)**, citing serious concerns with their data and their statistical model.

With the benefit of more data, Khandker was able to improve their model, published in a 2005 update to the study, **"Micro-finance and Poverty: Evidence Using Panel Data from Bangladesh."** The updated findings showed that each additional 100 taka of credit to women increased total annual household expenditures by more than 20 taka. There were no returns to male borrowing at all. Khandker found that between 1991/92 and 1998/99 moderate poverty in all villages declined by 17 percentage points: 18 points in program areas and 13 percentage points in non-program areas. Among program participants who had been members since 1991/92 poverty rates declined by more than 20 percentage points—about 3 percentage points per year. Khandker estimated that more than half of this reduction is directly attributable to microfinance, and found the impact to be greater for extreme poverty than moderate poverty, which microfinance was found to reduce by 2.2 percentage points per year and 1.6 percentage points per year, respectively. Khandker further calculated that microfinance accounted for 40 percent of the *entire* reduction of moderate poverty in rural Bangladesh.

The AIMS Studies

In 1995 the United States Agency for International Development (USAID) launched the Assessing the Impacts of Microenterprise Services (AIMS) Project, which developed five tools (two quantitative and three qualitative) designed to provide practitioners a low-cost way to measure impact and improve institutional performance. The tools recommended comparing existing clients to incoming clients and using the difference between them to estimate program impact. The idea behind the methodology was that since both the clients and the comparison households had chosen to join the program, there should be no difference in their "entrepreneurial spirit." Otherwise, higher incomes among participants might simply be driven by superior business acumen. However, some experts, notably Dean Karlan in **"Microfinance Impact Assessments: The Perils of Using New Members as a Control Group" (2001)**, have called into question the validity of this type of comparison. Karlan warns that this design can yield biased estimates of impact because MFIs may have originally started to work with different types of clients than they currently serve (for instance, an MFI may have cautiously started out working with better-off communities before branching out to poorer areas), and because clients who chose to enroll earlier may differ from those who chose to wait and see before joining.

The AIMS Core Impact Assessments of SEWA (India), Zambuko Trust (Zimbabwe), and Mibanco (Peru) avoid this problem through the use of longitudinal data and non-client comparison groups. **"Managing Resources, Activities, and Risk in Urban India: The Impact of SEWA Bank" (2001)**, by Martha Chen and Donald Snodgrass, compared the impact of clients who borrowed for self-employment to those who saved with SEWA Bank without borrowing, and compared both groups to non-clients. Borrowers' income was over 25 percent greater than that of savers, and 56 percent higher than non-participants' income. Savers, too, enjoyed household income 24 percent greater than that of non-participants. These findings indicate that microfinance—credit or savings—can be quite effective. **"Microfinance Program Clients and Impact: An Assessment of Zambuko Trust, Zimbabwe" (2001)**, by Carolyn Barnes, found that while clients' income was significantly higher in 1997 than the incomes of other groups, by 1999 the difference was no longer statistically significant, though continuing clients still earned the most. **"The Impacts of Microcredit: A Case Study from Peru" (2001)**, by Elizabeth Dunn and J. Gordon Arbuckle Jr., found Mibanco clients earned $266 more *per household member* per year than non-participants.

Wider Impacts

Empowerment

Hashemi, Schuler, and Riley, in **"Rural Credit Programs and Women's Empowerment in Bangladesh" (1996),** used a measure of the length of program participation among Grameen Bank and BRAC clients to show that each year of membership increased the likelihood of a female client being empowered by 16 percent. Even women who did not participate were more than twice as likely to be empowered simply by virtue of living in Grameen villages. This may suggest that a positive spillover from microfinance is affecting the norms in communities, but it could also imply that Grameen selects relatively empowered communities for program placement.

Contraceptive Use

"Poverty Alleviation and Empowerment: The Second Impact Assessment Study of BRAC's Rural Development Programme" (1998), by A. M. Muazzam Husain, reported that members who had been with BRAC the longest had significantly higher rates of contraceptive use. ***Fighting Poverty with Microcredit*** found credit provided to women *reduced* contraceptive use among participants. However, as discussed above, the results from Khandker's earlier work may be unreliable. **"The Impact of an Integrated Micro-credit Program on Women's Empowerment and Fertility Behavior in Rural Bangladesh" (1998)**, by Steele, Amin, and Naved, estimated that, even after statistically controlling for prior contraceptive use, borrowers were 1.8 times more likely to use contraceptives than the comparison group. Membership in a savings group was not found to have an effect. However, analysis of the actual number of births did not reveal a statistical relationship between either savings or credit and fertility.

Nutrition

Barbara MkNelly and Christopher Dunford, both of Freedom from Hunger, completed two comprehensive evaluations of Credit with Education programs: **"Impact of Credit with Education on Mothers and Their Young Children's Nutrition: Lower Pra Rural Bank Credit with Education Program in Ghana" (1998)**, and **"Impact of Credit with Education on Mothers and Their Young Children's Nutrition: CRECER Credit with Education Program in Bolivia" (1999)**. In Ghana, participants experienced an increase in monthly nonfarm income of $36, compared to $17 for the comparison group. Participants were more likely to breastfeed their children and more likely to delay the introduction of other foods into their babies' diets until the ideal age, and they were more likely to properly rehydrate children who had diarrhea by giving them oral rehydration solution. These impacts paid off in a significant increase in height-for-age and weight-for-age for children of participants. **"Credit Programs for the Poor and the Health Status of Children in Rural Bangladesh" (2003)** by Pitt, Khandker, Chowdhury, and Millimet, found substantial impact on children's health (as measured by height and arm circumference) from women's borrowing, but not from male borrowing, which had an insignificant or even negative effect.

Determinants of Impact

Control of Loan

In ***Women at the Center,*** Helen Todd found that a quarter of clients in her sample were turning over their entire loans to their husbands. Todd described these women as the most marginal in her sample; though they represent only 25 percent of the members, 41 percent of the borrowers who were still poor after 10 years of participation were among this group. Other studies, however, found that that even in the case where women have the least control—i.e., women channeling their entire loans—women are better off with microfinance than without. **"Rural Credit Programs and Women's Empowerment in Bangladesh"** confirms this conclusion, finding that 36 percent of Grameen and BRAC borrowers with no control of their loans could be considered empowered, compared to only 9 percent of women in comparison villages.

Incoming Poverty Level

The Second Impact Assessment Study of BRAC found that BRAC members' non-land assets were 380 percent greater than those of comparison group households, and net worth was 50 percent higher. Significantly fewer BRAC households were poor (52.1 percent of BRAC households versus 68.6 percent of the comparison group). However, subgroup analysis revealed that landless clients (the poorest clients) benefited least from the program, while those with 1-50 decimals of land ("the poor") benefited most. Another study, **"Monitoring diversity of poverty outreach and impact of microfinance: a comparison of methods using data from Peru" (2005)**, by Copestake et al., found that impact for the wealthier half of Promuc clients was 80 percent higher than the impact for the poorer half.

However, other studies, including **"Micro-finance and Poverty: Evidence Using Panel Data from Bangladesh,"** found that the poorest clients benefited most from participation. **"The Maturing of Indian Microfinance" (2004)**, by EDA Rural Systems, supports this conclusion, showing that while non-poor clients most often reported an increase in household income, they didn't do much better than non-clients. Compared to non-clients, the very poor benefited most from program participation.

Family Crises

In ***Women at the Center,*** Helen Todd found that out of the 17 Grameen Bank borrowers who were still poor after a decade, ten of them had experienced a serious illness in the family in the three years before her study. According to Todd, the families that suffer crises were almost always forced to sell off assets to pay for medical treatment and to support the family through the loss of income from the husband or the wife. Other studies show mixed results on the effect of crises. Another Todd study, "**Paths out of Poverty: The Impact of SHARE Microfin Limited,"** found though 49 percent of SHARE clients had experienced a family crisis or natural disaster in the previous four years, they were no more-or-less likely to have experienced an increase or decrease in poverty. Todd attributed their ability to cope with crises to their extraordinary savings rates. **"Moris Rasik: An Interim Impact Assessment,"** edited by David Gibbons, however, corroborates Todd's earlier findings from *Women at the Center* (this time with a larger sample size). Among clients who had experienced both serious illness *and* death in the family, nearly 60 percent remained Very Poor, versus only 40 percent for those who had experienced serious illness only. These results highlight the need to further develop savings and insurance products for the poor.

RESPONSES FROM MR. JOE MWANGI-KIOI, DIRECTOR OF MONITORING AND EVALUATION, GRAMEEN FOUNDATION USA, TO QUESTIONS SUBMITTED FOR THE RECORD BY THE HONORABLE CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY AND CHAIRMAN, SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS AND INTERNATIONAL OPERATIONS

Question:

You stated in your testimony that reporting requirements to Congress connected with the Microenterprise Results and Accountability Act of 2004 "can perhaps be consolidated." In what ways do you believe that such requirements could be improved to balance the need of Congress to stay aware of USAID's microenterprise activities with its desire not to unduly burden or distract USAID staff?

Response:

We feel that it is crucial for USAID to report to Congress in a timely manner, especially as it relates to overall performance and implementation of the Microenterprise Results and Accountability Act of 2004, and the appropriate emphasis on poverty reduction reflected therein. However, our impression from USAID staff is that some of the reporting requirements that have accumulated over the years are perceived as duplicative and do not necessarily advance the goal of maximizing positive impact on the very poor.

Given the limited funding available for USAID's operating expenses and the current staffing level, we suspect that the array of reporting requirements confronting USAID's Office of Microenterprise Development, not just those established by the Act, could possibly be streamlined to reduce the administrative burden of reporting, without diminishing the quantity or quality of data reported. At this juncture, without knowing specifics, we would be open to entering a discussion with USAID and other stakeholders regarding aspects of the reporting mechanisms that could potentially be "consolidated". Perhaps USAID can be asked to suggest areas where reporting may be simplified to allow them to have greater impact within the context of accountability for poverty reduction outcomes while also reporting to Congress on the implementation of the act. Such suggestions could then be reviewed in a process of dialogue between Congress, practitioners, and USAID to ensure a smooth and mutually acceptable solution.

Question:

You stated in your testimony that "USAID staff should be given latitude" in terms of "being held accountable for reaching the poorest and achieving results." Do you believe that the provision of the 2004 Act which mandates that at least half of all microenterprise funding go to the very poor is too restrictive?

Response:

No, I do not believe that the referenced provision of the Act is too restrictive. In fact, we welcome the provision of the Act that mandates that at least half of the funding is targeted to programs to benefit the very poor. We feel that mandating that 50% of the funds be allocated toward the poorest is not too restrictive but is in fact essential.

Within the context of being held accountable for maximizing reaching the poorest and of achieving results, we also feel that efforts could be made to ensure that USAID technical and administrative staff has the flexibility—within the confines of USAID's regulations and the Law—to fully use their talents and resources to maximize the anti-poverty impact of microfinance and microenterprise development. Based on our experience, it is our perception that sometimes USAID staff are constrained in their ability to adapt to often fluid on-the-ground context, in part by the requirements of their own regulations and other factors, such as various well-intentioned Congressional reporting requirements that have evolved over the years.

For example, during implementation of our highly successful program collaborating with the LAPO NGO in Nigeria, under USAID's IGP program, USAID staff were able to focus on results and impact and support our efforts to expand access to microfinance services for the poor and very poor. We commend this flexibility and hope that USAID staff could be encouraged to be flexible and supportive of NGO partners in similar situations.

Question:

Some are concerned that increasing amounts of U.S. microenterprise funding are being funneled through for-profit firms and decreasing amounts are going through non-profit NGOs and PVOs. As a result, the 2004 microenterprise legislation recommends that USAID emphasize the latter. What can for-profits do that non-profits cannot do? How do the overhead costs differ between for-profits and non-profits?

Response:

As detailed in recent USAID reports, a very significant percentage of USAID support for microfinance and microenterprise programs is allocated toward for-profits, especially when the umbrella project(s) are taken into account, the award of the FIELD LWA to a consortium of non-profits notwithstanding. Generally speaking, the non-profit member organizations of the Microenterprise Coalition are concerned that a disproportionate share of USAID support is targeted toward for-profit organizations, and more importantly, that the playing field is not level. All of the Coalition members strongly support the Act's appropriate emphasis on funding non-profit organizations that promote expanding access to services for the poor and very poor, within the context of a level playing field that has the interests of the poorest people in developing countries and the organizations that serve them at its center.

However, this concern should not be construed as concern that for-profits are not providing quality service. Rather, it is a reflection of the different focus of the type of projects implemented by for-profit and non-profit organizations. While both for- and non-profit type organizations are advancing goals related to poverty alleviation and development, generally speaking the non-profits are focused on providing services directly to the poor and the poorest. The core competencies of the two types of organization are typically different, although they may occasionally overlap. Working through contracts and task orders, the for-profits are typically providing targeted, short-term interventions that focus on fostering "enabling environments" including training, advocacy/policy analysis, and research. By definition, the scope of their work is limited and payment is based on completion of documented milestones. In our experience, most for-profits have focused on small and medium sized enterprises which do not include retail services for poor and disadvantaged individuals and their families. In contrast, the non-profits are fulfilling a mission to expand access to microfinance and microenterprise services (direct service provision) that interacts directly with the poor and the very poor. Working in collaboration with other international organizations through mechanisms such as SEEP or the Coalition, the non-profits directly impact the poor by providing targeted technical assistance, capacity building, loan capital, and knowledge management services within and outside their networks of MFI partners and affiliates. At the most general level, the non-profits are focused on producing outcomes such as community empowerment while the for-profits are focused on producing and documenting project level inputs as an element of contract performance. *The key difference is a matter of organizational focus, not of quality of output or performance.*

While individual organizations may possess one or more comparative advantage reflecting the firm's experience, the true strength of the non-profit is the focus on providing services directly to the poor, generating quantifiable impacts on poverty alleviation. An additional strength is that many non-profit organizations are able to marshal considerable matching resources (cash, in-kind, and volunteers) to offset the costs of their interventions. These matching funds not only leverage taxpayer monies but they also promote sustainability.

While it is true that overhead or indirect costs among for-profit and non-profit firms can appear to differ greatly, in practice there is far less variation than one might think. However, as USAID found when carrying out its umbrella projects study, it is almost impossible to do a rigorous analysis of differences in costs because it involves "comparing apples to oranges." For-profits and non-profits simply do not generally implement the same kinds of projects in the same contexts, making comparison difficult. That said, we assert that the mission or objective is the main thing, not price or cost-effectiveness per se, that differentiate between for- and non-profit type organizations. The important point for Congress is to ensure that taxpayer funds should go to support direct services for the poor and very poor.

Question:

One of the most pressing issues in Africa today is HIV/AIDS, especially its impact on children (AIDS orphans). How can microfinance programs address the HIV/AIDS crisis including prevention and also providing support for PLWA and AIDS orphans? As a practitioner, do you see effective programmatic integration strategies on the ground in African countries?

Response:

Alongside clinical/medical interventions and programs to promote abstinence, encourage prevention, and reduce stigma, microfinance programs can be an important element of a comprehensive strategy to address the HIV/AIDS crisis in Africa (and elsewhere). Today, many organizations are integrating livelihood components into ongoing HIV/AIDS programs and also many microfinance and mircoenterprise programs include components that address health and education. To an extent, such programmatic interventions exist in the African context today. However, given the urgency of the HIV/AIDS crisis and the need to reach the very poor, it would appear that there is room to enhance integration. Some examples of how microfinance and microenterprise programs complement mitigation programs and also support for PLWA and OVC are listed below.

- The microfinance worldwide infrastructure is extensive and already provides an effective, far-reaching, non-government mechanism to efficiently reach those affected by HIV/AIDS, including PLWA and OVC, particularly in very poor countries. Over 3,000 microfinance institutions are currently serving over 90 million clients worldwide. Of these, over 6 million clients are served by microfinance institutions in sub-Saharan Africa, with an additional 6 million clients served by credit unions. The vast majority of these clients are women, who are most vulnerable to HIV/AIDS for a variety of reasons.
- The lending methodologies of many—but not all—leading microfinance institutions are structured in a manner where members meet as a group every week to repay loans and are taught to develop the business and social skills needed to transform their lives. These structures are also suitable for incorporating HIV/AIDS education and counseling in a peer setting, and then for reinforcing those messages weekly. Members are also taught how to share this life-saving information with their children, their spouses and their communities, creating a powerful multiplier effect.
- Microfinance strengthens the link between HIV/AIDS education and awareness and behavior change. By creating economic empowerment for those most susceptible to high risk sexual behavior (vulnerable women), it mitigates such behavior by ending their dependence on undesirable partners or on bartering or selling their bodies for income. In short, it gives them the power to say, "NO."
- Microfinance contributes to the fight against HIV/AIDS by providing income-generating opportunities for people who are caring for infected family members or orphaned children, especially poor women. It affords AIDS widows and other AIDS victims the necessary support structure and economic means to begin new lives. Innovative savings, insurance and training programs have been developed to address their needs.
- Microfinance can be scaled to address the massive need in the fight against HIV/AIDS. The already successful, existing programs have a track record of measurable results and can be quickly scaled up to serve even more families and communities impacted by the HIV/AIDS pandemic.
- Microfinance is sustainable and generates ongoing returns. Every dollar committed to microenterprise development is multiplied several times over as loans are repaid and recycled into more loans (the loan repayment rate is 98%). Incorporating a sustainable, income-generation and empowerment program as a part of a strategic response to HIV/AIDS will ensure that millions of people are relieved from some of the worst economic consequences of the pandemic.
- The potential for expanding microfinance activities in Africa is vast, as are the opportunities to adapt microfinance instruments for AIDS-affected communities. To show the potential impact of microfinance in this respect it is worth noting that if current activities could be expanded to reach just an additional 500,000 very poor women in Africa, 2.5 million lives could be impacted. The estimated cost of reaching these half a million women is just $100 million and the benefits will be spread to their communities and families, playing a critical role in the fight against AIDS and extreme poverty[1].

As is evident from the above points, it is clear that effective programmatic integration strategies on the ground in African countries are possible and as a practitioner I have witnessed several programs that are successfully applying these methodologies to change the lives of PLWA and AIDS orphans.

[1] The Microcredit Summit's Declaration and Plan of Action estimated that it costs $200 per poor client: $150 in loan capital and an additional $50 in technical assistance and institutional development costs. (www.microcreditsummit.org)

Question:

What is your opinion of the level of technical quality of microfinance programs funded and implemented by USAID?

Response:

The member organizations of the Mircoenterprise Coalition appreciate the support and leadership provided by USAID in the past and currently. Broadly speaking, the technical quality of microfinance and microenterprise programs supported by USAID (to the best of our knowledge, USAID does not directly implement programs) varies, depending on the technical expertise housed in the respective USAID Mission(s). Some USAID missions that lack specific expertise in microfinance have approved projects that do not meet global best practices, for example: allowing subsidized rather than sustainable interest rates, supporting projects that are weak in their outreach to women; and focusing on SME (Small and Medium Enterprise) to the exclusion of microenterprise. Other missions with greater technical capacity or that have accepted technical assistance from the Office of Microenterprise Development (OMD) have done better. For example, USAID/Cairo has developed an innovative program to reduce poverty among poor women. Additionally, we would again cite the excellent support for the Grameen Foundation IGP implementation of the LAPO project in Nigeria. We applaud these efforts and call on other Missions and Bureaus to emulate their success. The practitioner community particularly encourages USAID to support programs that emphasize enhancing access to microfinance services among the poorest and most disadvantaged, especially women, and also programs that integrate interventions that promote health, education, local governance, and women's empowerment.

To ensure technical quality of microfinance and microenterprise programs, it is essential to ensure ongoing support for a robust Office of Microenterprise Development within USAID/Washington that can provide expert technical leadership and also central funding to support innovation and knowledge management. Despite the Act and congressional recommendations given in appropriations reports, these kinds of central funding mechanisms are still not up to the level mandated by Congress. In our opinion and experience, USAID's support for microfinance and microenterprise is most effective when USAID invests in microfinance institutions that are affiliated with international networks, including Coalition member organizations such as Opportunity International, FINCA, and the Grameen Foundation. These networks provide strong technical assistance and capacity building that support sustainable expansion of access, introduce innovative products and services, and share learnings and best practices across the entire industry. This is illustrated by the fact that of the twenty largest microfinance institutions (in terms of total assets) 14 or 70% are affiliated with international networks (The Mix, August 2006). Clearly, USAID's past and continuing support for technically strong, innovative, sustainable programs will be critical if microfinance and microenterprise are to realize the goals of lifting millions more out of poverty permanently.

RESPONSES FROM GARY M. WOLLER, PH.D., PRESIDENT, WOLLER & ASSOCIATES, TO QUESTIONS SUBMITTED FOR THE RECORD BY THE HONORABLE CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY AND CHAIRMAN, SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS AND INTERNATIONAL OPERATIONS

Question:

One of the key goals of microfinance is to alleviate poverty. What studies have been conducted, and what were their findings, regarding whether microfinance and microenterprise programs are actually increasing income levels of individuals to raise them out of poverty?

Response:

There have been well over 100 impact assessments of microfinance programs conducted since 1990. Two relatively recent studies by Goldberg (2005), "Measuring the Impact of Microfinance: Taking Stock of What we Know," and by Morduch and Haley (2002), "Analysis of the Effects of Microfinance on Poverty Reduction," have summarized many of findings of these impact assessments. Both generally concluded that microfinance does have a positive and significant impact on poverty reduction. Morduch and Haley write (p. 2):

- Evidence shows the positive impact of microfinance on poverty reduction as it relates to the first six out of seven Millennium Goals.

- While the quality of many studies could be improved, there is an overwhelming amount of evidence substantiating a beneficial effect on:
  - Increases in income
  - Reductions in vulnerability
- There are fewer studies with evidence on health, nutritional status and primary schooling attendance, but the existing evidence is largely conclusive and positive.

Goldberg (p. 46) similarly concludes: "This review of the literature provides a wide range of evidence that microfinance programs can increase incomes and lift families out of poverty. Access to microfinance can improve children's nutrition and increase their school enrollment rates, among many other outcomes."

This is the same basic conclusion I have reached through my own experience and research. The preponderance of evidence strongly suggests that microfinance can be a catalyst to help lift people out of poverty. More commonly, however, it is a critically important tool (among many tools) to help poor and vulnerable households manage risk, smooth household cash flows, and cope with shocks.

This said, impact of any particular microfinance program cannot necessarily be assumed. Impact is a function of several factors, including the microfinance program itself (and its programs, policies, products, service quality, etc.), the economic environment, the political environment, power relationships within communities, entrepreneurial talents and drives of clients, and so forth. These factors will combine in an endless array of combinations to affect the ultimate impact, whether for better or for worse.

Question:

You suggest in your written testimony "an approach that grants more emphasis to savings." Is it your view that the Microenterprise Results and Accountability Act of 2004 focuses too strongly on loans? How would you change the legislation?

Response:

To begin with, it is important to note that the Microenterprise Results and Accountability Act does not refer solely to lending. The language also refers to savings, training, technical assistance, business development services, and other financial services. In language, therefore, the Act covers a gamut of services, both financial and non-financial.

My frame of reference in my written testimony was principally poverty outreach. Savings are rarely mentioned in the context of poverty outreach, or more broadly in the context of social impact. This outcome reflects a distinct lending bias in the microfinance industry, which is both a cause and a result of the idiosyncratic way in which the industry has developed. My impression is that this bias is replicated in the practical application of the Act, if not in its actual language. A clear example of this is that the poverty tools requirement is being applied solely to loans, and there is nothing in this context to acknowledge the importance of savings to the very poor or the necessity to reach down the socio-economic ladder with voluntary savings services.

Given that the language of the Act already refers to savings, I do not see that a revision of the Act is required. I believe a better route would be for the appropriate industry stakeholders (of which USAID is a major one) to do more to encourage and facilitate savings via a set of positive incentives. Congress can help this process along by providing the appropriate incentives, primarily through its funding mechanism (preferably without reducing other funding for microfinance) and by working with USAID and other industry stakeholders to create guidelines for disbursing the funds. A pot of money, for example, could be established to support research, to provide technical assistance, to encourage innovation, or to support field experiments in savings. This might, I suppose, require some amendment to the Act, but again preferably this would come about as a result of "moral suasion" and productive collaboration between USAID and other industry stakeholders. (USAID has supported a substantial amount of action research through its AMAP funding mechanism. So, much of this kind of research and experimentation may already be going on. It might be useful for Congress to apprise itself of the work done under AMAP and how this might be useful in helping Congress achieve its policy objectives.)

Question:

Why do you believe that the legislation's focus on the very poor is inappropriate? In what ways does it take away from USAID's ability to ensure microfinance programs that truly benefit their clients in the most meaningful way?

Response:

Let me be clear at the outset that I do not oppose an emphasis on the very poor nor do I oppose developing tools to measure outreach to the very poor. In fact, I believe that both are vitally important if microenterprise development/microfinance is going to reach very poor persons in large numbers and on a reasonably sustainable basis. I support the efforts of dedicated activists who work tirelessly to help keep our eyes focused on this goal, and I applaud Congress' evident interest in this outcome. I suspect that absent constant vigilance in this area, the forces pulling microenterprise development/microfinance providers up-market over time may prove irresistible.

My primary concern (and it is more of a concern than an objection) is that the narrow focus on the "very poor" creates the potential situation in which large swaths of the poor and vulnerable non-poor remain outside the reach of USAID support. To the extent that Congress intervenes to channel resources to particular market segments, I believe it would have been more appropriate, and with a much larger impact, to broaden the focus to include the poor and the vulnerable non-poor as well.

As I mentioned in my testimony, I believe that the distinction between very poor and poor is arbitrary and often lacks meaning in practice. The extent of absolute deprivation in the developing world is staggering across wide cross-sections of the population living below, at, or above the very poor cutoff line. By any standard, tens of millions of persons living above the very poor cutoff line live in a state of significant material, social, and political deprivation. I see nothing to suggest to me that they are any less needful or deserving of either formal financial services or enterprise development support, nor that the corresponding benefits would be any less.

I understand fully that the current legislation only requires that 50 percent of funding go to support the very poor. In theory, this leaves plenty of funds left over to channel to the poor, vulnerable non-poor, and the non-poor. There are a number of alternative scenarios regarding the relative distribution of the remaining 50 percent to different market segments. In one plausible scenario, the poor and vulnerable non-poor receive a proportionate share of remaining resources. In another plausible scenario, however, the poor and vulnerable non-poor receive a disproportionately smaller share of remaining resources. I believe that the second scenario is more likely than the first scenario.

We must keep in mind that USAID has a number of objectives in allocating scarce funds to microenterprise development/microfinance. In addition to poverty alleviation, USAID seeks to promote private sector development and employment creation. As I mentioned in my testimony, the growth oriented firms that best promote private sector growth and employment creation tend (very broadly) not to be the petty trading and service enterprises that constitute the vast majority of clients reached by poverty-focused institutions. With one-half of its funding earmarked for poverty alleviation purposes, USAID must now use the remaining one-half to meet its other objectives, including private sector development and employment creation. It is natural and expected in this case that USAID will tend to prioritize these other objectives. The danger is that in doing so, a large segment of the poor and vulnerable non-poor get bypassed by commercially-oriented financial institutions targeting more up-scale clientele (among them the dynamic, growth-oriented micro, small, and medium enterprises). There is, therefore, a risk that a sole focus on the very poor will result in large-scale exclusion of the poor and vulnerable non-poor from USAID support, creating, in effect, a bifurcated market in which the poverty focused institutions are concentrating below or around the very poor line, while more commercially oriented institutions targeting more growth-oriented markets are concentrating above and around the poverty line, leaving large numbers poor and very poor persons outside the orbit of USAID support.

I should add here that employment creation is another indirect way to benefit the very poor. To the extent USAID helps promote private sector development and create private sector jobs in micro, small, and medium firms, it will create paid employment opportunities for very poor persons. It should be noted that a non-trivial, though unknown, share of "microentrepreneurs" are not entrepreneurs in the normal sense of the word, in that they are "reluctant" business owners. In other words, they start a business not because they want to run and grow a business, but because it is the only or best alternative they have. Many of these very poor "microentrepreneurs" would prefer paid-employment were it available. The key point here is that targeting larger growth-oriented businesses, many of which are owned and operated by the non-poor, can be an important part of a package of policies that benefit very poor persons. The problem is that at the moment, we do not have the means to measure the extent and quality of job creation nor the poverty status of persons hired.

I have other concerns as well. One is that in my experience, there is often a lack of meaningful distinctions between the very poor and poor, particularly among those clustering around the relevant very poor cutoff lines. Given inherent inaccuracies in any tool that attempts to create a very fine a measure of complex socio-economic phenomenon, I do not think we can say with a high degree of confidence that persons living on, say, $1.15 a day are consistently better off in a materially significant way than persons living on, say, $0.96 a day. I realize that a cutoff line needs to be drawn somewhere, but I am uncomfortable cutting the line so finely and at such a low level, particularly when I have my doubts that the tools we use to make the fine distinctions are up to the task. (I believe that the poverty assessment tools can do a very good job at making ball-park estimates, but based on my experience, I am skeptical they can make the very fine distinctions required of them. Thus, I prefer they be used more as ballpark estimates as opposed to finely tuned, precision tools.)

Another concern has to do with vulnerability. As several impact assessments have shown, financial services provide vulnerable households another tool to manage risk and to cope with shocks. Tens of millions of people living above the very poor line or the poverty line are vulnerable to falling below them. Often, all it takes is one setback, even sometimes a minor one, to send a poor or non-poor but vulnerable household spiraling down into poverty or extreme poverty. In this sense, microenterprise development/microfinance serve both to lift people out of extreme poverty and to keep them from falling into extreme poverty. The Act, unfortunately, only concerns itself with the people in extreme poverty today, not the people who may find themselves in extreme poverty tomorrow.

A final concern has to do with the issue of scale. The number of institutions interested in the very poor as a primary market is a relatively small sub-set of the industry. By focusing the Act on the very poor, the much larger number of institutions interested in reaching poor or vulnerable non-poor markets do not benefit from a tool that would help them target their services more effectively to this market, while USAID and the Congress are denied a means by which they can monitor outreach to these very large and very important market segments (and market segments with substantial significance for social impact).

In keeping with the language of the Act, IRIS is not calibrating its tools to identify the poor and vulnerable non-poor in addition to the very poor. This is highly unfortunate. It might easily have done so, and at relatively little marginal cost, thereby providing a set of tools of interest to a much wider market than those interested in serving the very poor. There are a large number of institutions targeting those below or clustering around the poverty line or those among the vulnerable non-poor. Many would potentially have found useful a tool that allowed them to measure poverty more broadly whether for social (e.g., creating social impact) or commercial (e.g., market segmentation) reasons. These same institutions, however, have little or no interest in a tool measuring extreme poverty, as they do not target this market.

Tools allowing institutions to measure poverty outreach more generally would also be of potentially significant interest to agencies and organizations outside of the microenterprise development/microfinance sectors. While some of the same agencies and organizations will be interested in a tool identifying the very poor, many more would likely be interested in a tool identifying poverty more generally.

Thus, the inevitable result of the very poor focus is limited scale in terms of tool adoption and usage and in terms of creating social transparency in the industry. I see this as a tremendous lost opportunity to achieve potential wide-spread scale in social transparency.

(To reiterate a reference in my testimony, I believe that there are alternative ways to create wide-spread social transparency in the industry. USAID is at the forefront of this effort in its support of the social audit/social rating method, which I believe holds the most promise for achieving scale in social transparency across all types of institutions in all contexts and targeting all markets. Generally, USAID efforts to promote social transparency should be applauded and, more importantly, actively supported by Congress.)

I think that the idea of developing poverty assessment tools is a good one. I applaud the Congress' role in facilitating this process. In hindsight, however, there are five changes to the current Act I would recommend:

- Calibrate the tools to measure both extreme poverty and poverty.
- Build in an explicit fudge factor into the tools that takes in the "vulnerable non-poor," such as extending the tools to include those within a set number of deviations above the poverty line.

- Streamline the process significantly so that each tool for each country could be produced at a lower cost, allowing tools to be developed for more countries within a given budget.
- Disseminate each tool immediately on completion and place the impetus on the institutions to adopt and adapt them as meets their needs, while offering technical guidance as requested or needed.
- Create a pot or pots of money—including loan funds, administrative overhead funds, and technical assistance funds—for institutions exhibiting ability or commitment to reach very poor, poor, or other priority markets. This would take the place of the current 50 percent earmark for the very poor. The distinction between "pots of money" and percentage earmarks is subtle but meaningful. The latter ties the hands of the implementing agency (USAID in this case) setting in motion a unique set of behavioral incentives for both implementing agency and grant seeking institution, while the former creates, I think, greater flexibility to target and prioritize resources; potentially allows for greater collaboration and planning; and does not necessarily tie the hands of the implementing agency, thereby allowing it to act with wider discretion in meeting policy objectives as opposed to resource allocation targets. (Whether these distinctions play out in practice is uncertain.)

Outreach to the very poor, poor, or vulnerable non-poor could also be promoted via a variety of other means. For example, incentives for institutions to go down market further, not necessarily to the very poor, would be appropriate. Say an MFI or BDS provider is currently serving largely non-poor clientele but seeks to extend its outreach further down the socio-economic ladder, albeit not necessarily to the very poor. This institution might qualify for support under a particular funding/support program. The point here is less to reach a specific market segment but to promote downreach in general, which is a very laudable end and which is fully consistent with Congress' poverty mandate. I would argue that it is important to demonstrate that downreach is possible and that commercially-oriented institutions can successfully move down market and provide them models for doing so. Currently, however, there is nothing in USAID programming I am aware of to support this kind of activity.

Another possible mechanism to support deeper outreach might be through the matching requirement, which I believe is currently written into legislation. For example, institutions demonstrating outreach to a certain priority market might be relieved of certain matching requirements. The extent of the relief could correspond to some sliding scale depending on the depth of outreach sought or achieved.

In other words, there are other ways, and potentially more effective ones from a broader policy perspective, to achieve the sought-after policy objectives than the very blunt instrument of specific percentage funding earmarks.

In general, I think it more productive to think of program funding in terms of a suite of policy objectives, of which poverty alleviation (deep outreach) is but one of them, albeit an important one,. Funding allocations would in turn reflect the multiple policy objectives and incorporate explicit strategies to achieve them. The current Act, however, does not encourage this approach from what I can see. Instead, it uses a blunt instrument to promote a single policy objective, while giving comparatively little consideration to other important policy objectives. Thus while I think that the focus on the very poor is critically important, I also believe that disproportional focus on it risks producing unintended and unbalanced policy outcomes.

Question:

You suggest in your written testimony that more should be done to reach out specifically to rural populations in need of financial services. Do you believe that we would get better results if such an emphasis on rural areas replaced the current emphasis on the very poor?

Response:

If I *had* to choose between an emphasis on the very poor or an emphasis on rural areas, I would choose an emphasis on rural areas. I think what we will find is that the majority of very poor clients currently reached by poverty-focused MFIs live in either peri-urban or urban areas. One might argue that requiring lending to the very poor will incentivize MFIs to move increasingly into rural areas, but I am skeptical about this. Working in rural areas is very different than peri-urban and urban areas, such that it requires often a different approach, different program design, and a different product suite.

I should be clear also that when I talk about serving rural areas, I am referring specifically to supporting traditional rural-based activities, such as agriculture, agro-processing, and livestock rearing. My impression is that most of the MFIs working in rural areas today tend to focus on petty traders or service providers and not on traditional rural-based activities. These activities may support rural households, but they do comparatively little to build up rural economies.

That said, I do not believe it is necessary to choose between the very poor or rural areas. One can do both. Nor am I am not recommending that Congress require that a certain percent of microenterprise funds go to rural areas (such as it has for the very poor). Instead, I would recommend that it create a set of incentives (such as a "pot of money" for loan funding, administrative overhead, technical assistance, etc.) to encourage and facilitate expansion of outreach, and experimentation, in rural financial services that target traditional rural economic activities.

Just to make sure I am not misunderstood, I do not advocate shifting funding priority solely, or even predominantly, to rural areas. Promoting private sector development and poverty alleviation in periurban and urban areas remains critically important. I do, however, advocate placing greater emphasis on rural areas and on supporting significantly higher levels of funding, innovation, and experimentation in rural financial service provision and outreach. (Again, AMAP has funded research into rural lending and outreach, the results of which will undoubtedly be of significant help to Congress and USAID in addressing this issue.)

Question:

You write in your testimony that "outreach to women or to rural areas are probably superior proxies of poverty outreach than loan size, as we know indisputably that poverty is disproportionately concentrated among women and in rural areas." Can you elaborate on how USAID can most effectively promote outreach to women and those in rural areas?

Response:

I have already discussed how I believe USAID can most effectively promote outreach to rural areas. In terms of promoting outreach to women, available statistics suggest to me that USAID-funded institutions are doing a reasonably good job reaching women.

The broader industry has been promoting outreach to women for years now, and the message appears to have gained significant legitimacy, as judged by the number of MFIs targeting women and the relative percentage of women reached industry-wide.

I do find it a bit worrisome, however, that the percentage of USAID funds going to women appears to be trending downward. This may signal a number of things, among them: (1) a reduction in industry-wide commitment to serving women, (2) the particular characteristics of USAID funding, which may or may not reflect broader industry trends, or (3) a reallocation of funding to more growth-oriented businesses, which will tend (though with many exceptions) to be owned and operated by men. This trend should be monitored closely, and I would recommend that someone undertake investigation to determine its causes. (This last statement dovetails with my recommendations below to utilize the MRR database more extensively and effectively than to date.) Just like our commitment to serving very poor and poor populations requires constant vigilance, so too does our commitment to serving women.

As an aside, I would also add that if the policy objective is poverty outreach, a focus on women is highly appropriate. If, however, the policy objective is promotion of growth oriented microenterprises with capacity or potential for job creation, then a focus on women may be less appropriate. Very broadly speaking, my experience suggests that the women-owned enterprises served by poverty-focused MFIs are but one of several sources of household income and are operated with the purpose to diversify and smooth out household income flows. These enterprises are primarily involved in petty trading or small-scale services, tend not to create paid employment, and appear to have a natural and self-imposed growth ceiling. These enterprises are critically important in helping households smooth income and consumption flows, manage risk, deal with uncertainty, cope with shocks, and occasionally help lift households out of poverty. They play less a role, however, in terms of promoting private sector growth and job creation.

Thus if policy seeks the dual objectives of poverty alleviation and private sector development, it needs to seek a balance with regards to targeting women. (Again, this is intended only as a very broad generalization.) That said, there will be numerous exceptions to these general trends. A legitimate use of public money (and one I would encourage) would be to target loans or other enterprise development support to female-owned growth-oriented micro, small, and medium enterprises (including corresponding market research, product innovation, and pilot-testing).

In terms of targeting rural areas, and traditional economic activities in rural areas, I do not see any potential tradeoffs. If the policy objectives are private sector development and poverty alleviation, supporting farming, agro-processing, and other agro-based activities and enterprises is a highly complementary approach that serves both objectives.

Question:

What impact are the reporting requirements imposed in the 2004 microenterprise legislation having on microenterprise assistance implementing institutions? Do you expect the costs to these institutions of additional reporting to be high?

Response:

I cannot say what the impacts of the reporting requirements are. I can, however, state my opinion that this information is important and should be collected. I have no problem conceptually with requiring funding recipients to report as a condition for funding; the key is to keep the reporting requirements reasonable. As currently legislated, I think that the reporting requirements are generally reasonable.

An exception to this generality is the poverty reporting requirement for business development service providers, particularly since many BDS providers are not direct service providers; that is, they work through intermediaries and do not interact directly with micro and small enterprise owners). They are not in a position to know or ask the poverty status of end clients, and to find this out requires them either to (1) survey persons who are not their clients or (2) require the direct service providers to collect and report the poverty information. The former is not reasonable, while the latter adds another layer of reporting requirements, which is, in my view, not reasonable to expect.

I should add that I also believe that the information collected by USAID over all these years and currently stored in the MRR data base is being grossly underutilized. This is a potential treasure trove of information for the Congress, USAID, and the broader industry that remains almost completely untapped. I would encourage Congress and USAID to allocate funding specifically to develop this resource, fund research using it, and make it publicly accessible in usable formats. This, I think, would require a relatively small investment (although enough should be allocated to permit the job to be done well) that could pay off comparatively large dividends down the road in terms of informing Congressional and USAID policy. I know that Weidemann Associates (who manages the MRR data base) is both anxious and ready to take on this work, has the capacity to do so, and is willing to enter into consultation with USAID to find workable solution to make it happen.

RESPONSES FROM MS. SUSY CHESTON, SENIOR VICE PRESIDENT, OPPORTUNITY INTERNATIONAL, TO QUESTIONS SUBMITTED FOR THE RECORD BY THE HONORABLE CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY AND CHAIRMAN, SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS AND INTERNATIONAL OPERATIONS

Question:

You state in your written testimony that "the investment to date in the development of poverty assessment tools will truly pay off" in the future. As we heard from Ms. Schafer in the first panel, USAID is now working on country-level poverty assessment tools in the wake of serious problems with the originally-mandated tools intended for regional and international use. What is your view of these country-level tools? Do you believe they will provide the necessary degree of accuracy?

Response:

I agree with the USAID assessment that country-level (or even more localized) poverty measurement tools for microenterprise practitioners likely will be more useful and accurate than a universal international tool. I also have been impressed with the work by University of Maryland IRIS Center hired by USAID to carry out its tool development and certification process. I believe the USAID concentration on IRIS-developed tools was a legitimate effort to address legislative mandates in the context of few poverty measurement tools available and uncertainty on how to certify them without further development of tools.

However, the primary focus on creating a new USAID tool shifted away from the original intent of certification of existing or new tools developed by practitioners.

A practitioner-led process has many benefits, including the understanding of clients and ability to develop and implement tools that best reflect their missions and enhance internal program delivery capacity. More than 10 years ago, AIMS, a USAID-led impact measurement project, clarified that client assessment can serve not only to prove impact but, more importantly, to improve performance. In other words, a great strength of effective client assessment is not only to prove impact for use in donor decision-making, but even more so to allow practitioner organizations to improve their services to the poor.

For example, within Opportunity International, we made a significant investment in the development of a pioneering Client Insight Information Management System (CIIMS) which helps us to understand the kind of impact we are having on our clients and to develop products, services and procedures that better meet their needs. Despite that significant investment in a tool that reflects our mission, values and field realities, Opportunity is now at risk of needing to divert our resources toward multiple one-size-fits-all poverty assessment tools developed by USAID for each country. While Opportunity is committed to poverty assessment, it is not clear that the USAID country-specific tools will give us better information to encourage our downreach efforts than our own in-house tool.

Therefore, going forward, USAID efforts should put greater emphasis on the certification of practitioner-led tools that enable comparability of data but also serve internal needs. Now that USAID is developing tools on a country by country basis, USAID has wisely opened the door to analyzing what practitioners have developed and are using. To reduce the costs and difficulty of implementation, a balanced approach is needed that gives equal emphasis to certification standards that assure practitioner-preferred tools meet the poverty assessment needs, as well as providing practitioners and others with the resources to develop new tools for possible practitioner adoption.

Question:

You reiterated in your testimony your support for the provisions in the 2004 legislation which mandate that half of USAID's microenterprise funds reach the very poor. We just heard from Dr. Woller that such an approach might actually be, as he states in his written testimony, "an unduly limiting vision." What, if anything, would you say we lose by focusing on the very poor?

Response:

Dr. Woller is absolutely correct that there are other needs for funding for microfinance beyond a focus on the very poor. This would include such activities as bringing "second-tier microfinance institutions" to sustainability so they can tap into investment funds and no longer rely on subsidy from USAID or other donors. It also includes increasing our capacity to reach all those who are currently excluded from financial services, including clients who are "poor" (rather than "very poor"). Currently, 50% of USAID funds are available for these purposes. That seems to me to be significant funding, particularly when combined with other funding sources available to the industry, including $2 billion in investment capital, funding from other donor organizations and from private sources, and savings deposits that can then be on-lent.

The question then becomes what is the appropriate use of public funds. My belief is that USAID can be very strategic in taking risks that other funders are not able to take, and particularly by providing incentives for microfinance institutions to innovate in reaching lower levels of poverty.

In my 15 years in microfinance, I have never seen examples of microfinance programs that unintentionally drifted downmarket to serve poorer clients. I have, however, seen many examples of microfinance programs that drifted upmarket. Years ago, one of Opportunity International's partner microfinance institutions (MFIs) in the Philippines was very committed to reaching the very poor and thought it was doing so. But after a wrenching organizational review, it discovered that its loan officers were often choosing to work with the easier-to-reach clients—those closer to bus lines, with more visible businesses, those who were illiterate or easier to work with because they understood financial services and markets better. The discovery caused a total change of strategy. That's why incentives are so important at every level—incentives by USAID to all of its partners; incentives by microfinance networks to their partners; incentives by MFIs to their own staff; etc. It's simply harder to reach the poor and very poor—which is why commercial banks didn't do it until microfinance programs came along to show the way. Upreach is easier and therefore requires less subsidy; it's downreach that's the challenge.

I also agree with Dr. Woller's point that USAID can have a much stronger impact by focusing more of its funding on women and those in rural areas—both groups known to be disproportionately affected by poverty.

Finally, Dr. Woller makes an important point in his testimony that the requirement to target 50% of USAID funds to the very poor has faced difficulties in being applied to the enterprise development area. USAID reported that $93 million (44%)

of the $211 million in microfinance/microenterprise funds in 2005 went to microfinance and $94 million (45%) went to enterprise development projects. Another $23.9 million (11%) went to policy projects, the majority of which focused on enterprise development. USAID noted in its 2005 report that, based on the old reporting standard of loan size proxy, a far greater percentage of microfinance/financial services obligations went to the very poor (37%) than funds for enterprise development (18%). (The combined total for all FY 05 USAID obligations was 23%.)

In the case of both enterprise development and policy work, it is unclear how the current poverty assessment tools can best be applied. Is it congressional intent to exempt those activities from a focus on the very poor (which comprised a total of 56% of assistance), or to include those activities?

Question:

What track record has the Millennium Challenge Corporation had in incorporating microfinance and microenterprise into the compacts signed to date, and how do you think they could further be emphasized in those compacts moving forward? How could the MCA indicators more clearly ensure that microfinance is part of the mix?

Response:

Microfinance is a proven, cost-effective approach to economic growth, job creation, and personal self-sufficiency in developing countries, and given federal budget limitations, leveraging that value by integration into mainstream programs will yield a greater return on overall federal investment.

The Millennium Challenge Corporation (MCC) focus on poverty reduction through economic growth, private sector development, and capacity-building is a natural fit for microfinance efforts to add value. The MCC is especially important as the primary vehicle to direct substantial funding through the new foreign assistance framework.

As a stand-alone program in USAID without substantive integration into MCC and other programs, microfinance and microenterprise support can have a limited impact. The $200 million available to allocate worldwide, most of which USAID directs to activities other than direct financial services, is marginal compared with the billions invested in MCC. USAID reports that 69 countries received some kind of microfinance or microenterprise development funding in FY2005, including enabling environment, enterprise development, and microfinance projects. Of those countries, nearly three-fifths received less than $2 million. When Opportunity International has approached USAID missions in Africa with the commitment to bring significant private donor funding to match USAID funds, we have been told on several occasions that there is simply no discretionary funding available for retail microfinance to the poor.

Unfortunately, measuring the extent of microfinance focus or support in MCC compacts is difficult to assess based on available measures. Public MCC reports show spending on activities classified as "microfinance / microenterprise related" totals:

Armenia	3.6%	($8.5 million out of total $235 million)
Benin	6.4%	($19.7 million out of total $307 million)
Cape Verde	1.9%	($2.1 million out of total $110 million)
Honduras	4.5%	($9.8 million out of total $215 million)
Madagascar	7.5%	($8.2 million out of total $110 million)
Ghana	15%	($82.4 million out of total $547 million)

However, most of that MCC "microfinance" activity does not focus on direct service provision or retail financial services to the poor. Rather, they encompass a broad range of other interests, such as credit for larger businesses (small and medium rather than micro); agri-business; technology to support the commercial financial services infrastructure; technical assistance to mainstream commercial banks and rural banks; and enabling environment activities such as policy and regulatory reform. Therefore, the integration of microfinance and microenterprise likely is overstated.

Based on available information, it also is hard to very hard to determine whether the MCC compact development process, technical assistance, or monitoring / evaluation places adequate emphasis or incentives on microfinance as a central element of poverty reduction through economic growth. In part, this may be attributable to the principle that recipient countries, not the donor, have primary ownership in conceiving, developing, and implementing a program.

Nevertheless, the high impact of microfinance programs and their importance in strengthening the informal / private sector is a critical consideration for MCC to be effective. At a minimum, MCC should proactively promote linkages between countries that are developing compacts and the international microfinance provider networks that can provide insights, assistance, and additional resources. At best, MCC would incorporate factors of microfinance access and microenterprise development into its evaluation criteria. Opportunity International and the microfinance network are eager to pursue such a relationship with MCC in order to help achieve our shared goals.

Question:

Microfinance is a proven strategy to reach women and to unleash their participation in their own development as well as the development of their communities. What more could USAID do to ensure that microfinance and microenterprise programs benefit women?

Response:

USAID is to be commended for some significant successes in encouraging a greater focus on unserved women. For example, according to a USAID report, in fiscal year (FY) 2000, six Egyptian microfinance institutions reported a total of 72,634 clients, with an average loan size of $506. Only 17 percent of these clients were women. In FY 2002, these same institutions reported 115,345 clients (a growth of 59 percent) with an average loan size of $372 and that 54 percent of these clients were women. This dramatic and positive change came about because the USAID Mission strongly encouraged its long-time grantees to add a new poverty-targeted group-lending product specifically designed for women, which now accounts for virtually all of their growth. This kind of awareness of both gender issues and microfinance best practices should continue and be expanded throughout USAID's microfinance and microenterprise development programs.

At the same time, microfinance programs can have a tremendous impact on women's empowerment, but simply getting cash into the hands of women (in the form of loans) is not always enough. Programs that integrate intentional activities to encourage women's empowerment, such as leadership development, domestic violence, women's rights, political participation, literacy, and the like, can be much more effective in promoting empowerment. Yet USAID RFPs generally have been focused on the financial performance of microfinance institutions and have generally not encouraged these kinds of integrated activities nor specific efforts to target women.

My recommendations are as follows:

1) USAID should disaggregate all data by sex. This includes ensuring that client impact and poverty assessment tools funded, developed and/or certified by USAID are sex-disaggregated and take into account intrahousehold dynamics. It also includes reporting sex-disaggregated client outreach data in its Microenterprise Results Reporting (MRR). Interestingly, in the past, USAID's Office of Microenterprise Development has been a stand-out in sex disaggregating much of its data in past MRR's, responding to the provision in Public Law 106–309: Microenterprise for Self-Reliance Act of 2000 to make "recommendations for adjustments to such assistance to enhance the sustainable development impact of such assistance, particularly the impact of such assistance on the very poor, particularly poor women." With the new streamlined report for 2005, which was very well done, USAID unfortunately did not report on client data and therefore did not include information on women clients other than on the human trafficking issue.

2) USAID should award points for microfinance and microenterprise development programs that address the specific needs, assets and obstacles of women. This would include programs that:

- intentionally integrate women's empowerment activities
- demonstrate gender equality in their boards, management and field staff
- provide evidence of women's involvement in the design and implementation of their programs
- develop alliances with women's organizations
- demonstrate an awareness of the specific constraints faced by women within their context as well as strategies to address those constraints
- demonstrate specific outreach to women clients
- design products and services that are gender-sensitive and address intrahousehold dynamics
- mainstream gender perspectives throughout their organizations
- provide products to help women who are ready to graduate to more sophisticated financial products

3) USAID should report on its efforts to address exploitation of and violence toward women through such programs as integration of client training into microfinance programs and development of linkages with other NGO's. PL108–484 provided that USAID report on "the efforts of the Agency to ensure that recipients of the United States microenterprise and microfinance development assistance work closely with nongovernmental organizations and foreign governments to identify and assist victims or potential victims of severe forms of trafficking in persons and women who are victims of or susceptible to other forms of exploitation and violence." USAID's 2005 report to Congress included a response related to human trafficking but does not address "other forms of exploitation and violence."

4) Congress should request a report on USAID's efforts to achieve the above. USAID's Office of Microenterprise Development (OMD) has much to share about its accomplishments. A document developed by OMD could be helpful in ensuring an agency-wide review of existing practices and in promoting best practices for the future. This is especially important in the context of declining trends in microfinance services as the microfinance industry commercializes and institutions become larger.

Finally, I recommend support for the GROWTH Act for Women (the Global Resources and Global Resources and Opportunities for Women to Thrive Act, H.R. 5858). The GROWTH Act would create important changes in U.S. international assistance and trade programs by prioritizing economic opportunity for women living in poverty worldwide.

Question:

There has been some concern that the Microenterprise Development Office has had insufficient levels of funding to use for its own programs and has not received the level of funding authorized in 2004. Should most funding for microenterprise assistance flow from Washington or from USAID missions? What are the advantages and disadvantages of each? What will be the impact on microenterprise assistance of the "transformational development" reforms that reportedly aim to centralize much of project funding and decision-making?

Response:

I have some concerns about the overwhelming trend for funding to be directed through missions as opposed to central mechanisms. Administrator Natsios implemented a major restructuring to direct more USAID funding through missions and, as noted, Ambassador Tobias is expected to carry this trend much farther due to his "transformational development" reforms that emphasize country-level strategies and budgets. The benefits of funding through USAID missions are clear and include: a greater understanding of local contexts, decisions being made closer to the field, and greater potential for cohesive, synergistic, non-duplicative programs within a given country.

However, there are some disadvantages to this approach for microfinance and microenterprise:

a) Microfinance and microenterprise have evolved into highly technical, specialized fields requiring knowledge of banking, finance and the like. For instance, in many cases, microfinance institutions are converting to regulated financial intermediaries/commercial banks that are regulated by the Central Bank. Further, the industry is rapidly evolving, with best practices of yesterday being replaced by higher performance standards today. Mission staff rarely have the kind of specialized expertise necessary to ensure that these programs follow global best practices.

b) The 2005 USAID Microenterprise Results Reporting notes that 20 missions benefited from Office of Microenterprise Development (OMD) input in developing their microfinance strategies, per PL 108–484's mandate that OMD concur with mission strategies. However, that presumably leaves 49 missions that have not benefited from that kind of technical input.

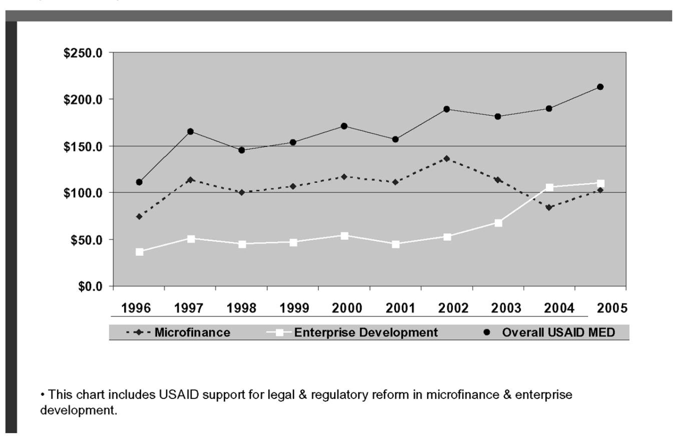
c) Much of the success and global leadership of USAID in microfinance has been its investment in the establishment of market leaders. In the 1990's, USAID accomplished this by investing in not-for-profit global microfinance networks, which in turn created world class microfinance institutions in many parts of the world. These networks are able to match federal funds with other funding, create global economies of scale, share learnings within their networks and across networks, build capacity for direct provision of services to the poor and very poor, and encourage cultures of excellence that benefit countries across the globe. Most of all, they develop long-term relationships with their field partners that lead to higher capacity and better performance. Without central funding mechanisms designed for participation by not-for-profits, USAID loses the ability to tap into this significant resource for dramatically increasing the impact and outreach of microfinance.

For example, in 1991, after 20 years in business, Opportunity International had 6,000 clients. Today, only 15 years later, Opportunity has 850,000 loan clients, along with 3 million poor people who now have basic micro insurance to protect them in the event of disaster or disease, plus a growing number of savings and remittance clients. That kind of exponential growth in numbers and in range of services is found throughout our industry and was largely stimulated by strategic investment by USAID. Yet Opportunity is one of the majority of microfinance networks that have seen its USAID funding decline significantly despite a track record of results.

d) Microfinance is currently at a crossroads when explosive growth is possible at a global level. Thirty to fifty million people today have access to microfinance services—yet 300 to 500 million people are still excluded from basic financial services and yet could benefit from them. A global strategy is called for—yet no international donor or investor has stepped up to the plate to help develop that strategy. USAID is well positioned to provide that kind of global leadership, as it has in the past—but this requires a vital central office with strong technical skills that is well positioned to coordinate agency efforts and to work closely with the practitioner community and others.

e) The trend to distribute funds through missions has led to a significant increase in the percentage of funds awarded through umbrella contracts and umbrella projects. From 1996–2005, there has been a general trend toward lower spending by USAID on microfinance/financial services and at the same time a greater reliance on umbrella mechanisms. Smoothing out year-by-year fluctuations, we see that at the start of the period, umbrellas accounted for approximately 9 percent of all microfinance funding ($10m/$115m), while in 2004, umbrellas accounted for over 38 percent. In 2005, the amount obligated to umbrella programs was 51 percent ($107m/$211m), and only 37 percent of the microfinance and microenterprise support was obligated directly to non-profits.

USAID Support for Microenterprise Development, FY 96-05
(Millions)



f) Funding for retail microfinance has declined and should be increased. It is hard to separate out the question of central versus mission mechanisms from the question of what kinds of programs those mechanisms support. A great deal of the increase in assistance in recent years has gone to support enterprise development and policy activities rather than retail microfinance/financial services for the poor. USAID's data shows that retail microfinance funding has stagnated or decreased despite the increase in overall funding for microfinance/microenterprise development. The Microenterprise Coalition believes that USAID's most important goal in the microfinance area should be expansion of financial services to the poor. That goal requires a focus on building the capabilities of direct service providers: retail MFIs (microfinance institutions). Projects that address "industry infrastructure" such as credit bureaus or regulatory reform can be important and can support direct service providers but should not be the primary focus of USAID's microfinance-related assistance, including its umbrella programs. The Microenterprise Coalition further believes that a significant majority of umbrella program funds should go to direct service providers that directly work with poor and very poor clients.

With respect to the "transformational development" reforms currently underway, the microfinance community joins with the rest of the PVO community in expressing concern that the process to date has been closed to input from PVO's and practitioners in general. We understand that the Director of Foreign Assistance is now beginning to open up to input from civil society and request that Congress encourage this new openness and responsiveness. An August 1, 2006 dialogue with members of InterAction was a good start.

The lack of an open process to date makes it difficult to comment in any detail on the proposed "transformational development" reforms. That said, the concern expressed by many in the PVO community and at USAID is that a "niche" program such as microfinance will get lost in the context of country-level planning that may be carried out by people who lack specific microfinance expertise. Further, we wonder whether or not economic growth will be fully embraced as a key strategy, and whether microfinance/microenterprise will be recognized as a means for poor people to contribute to and benefit from economic growth. The Microenterprise Coalition would welcome the opportunity to meet with the Director of Foreign Assistance and his designates to further explore these issues.

RESPONSES FROM THE HONORABLE JACQUELINE E. SCHAFER, ASSISTANT ADMINISTRATOR, BUREAU FOR ECONOMIC GROWTH, AGRICULTURE AND TRADE, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT TO QUESTIONS SUBMITTED FOR THE RECORD BY THE HONORABLE CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY AND CHAIRMAN, SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS AND INTERNATIONAL OPERATIONS

MICROENTERPRISE

Question:

What does USAID believe is the best way to create effective, sustainable microfinance programs? In your agency's view, should there be a particular focus on any of the Office of Microenterprise Development's three aid areas (financial services, enterprise development, and enabling environment)?

Response:

USAID believes that the best way to create effective, sustainable microfinance programs is to develop the microfinance industry as a whole and the market infrastructure it needs to thrive. National microfinance markets vary significantly in terms of their state of development and the constraints that must be addressed to produce a mature microfinance market. Effective, sustainable microfinance programs employ the most appropriate measures to reduce these constraints.

These measures can include support for building sustainable retail microfinance institutions; for conducting market research and developing new products that will ensure that microfinance institutions provide the services that their clients demand; help for microfinance institutions so they can gain access to commercial capital; and support for technology solutions that can extend outreach and reduce transaction costs.

Similarly, USAID believes that each of its three technical areas (financial services, enterprise development, and enabling environment) could be an area of particular focus, depending upon market conditions. This approach recognizes the multiple, complex needs that businesses have, their need for links with other firms, and the constraints that a poor policy environment might pose. This approach also recognizes that financial service, enterprise development, and enabling environment programs, when combined within a single country, often achieve synergistic effects.

Low-income households and entrepreneurs need financial services to meet diverse business needs—savings, credit for working capital and investment, and payment services to carry out everyday commercial transactions. In addition, they and their families need access to diverse financial services (savings, credit, insurance, remittance and payment services, transaction accounts) for non-enterprise purposes—to invest in education and new skills; to build assets, such as homes; to smooth consumption when times are lean; to plan for weddings, funerals, births, old age, deaths, and other life cycle events; and to help cope with the emergencies and other crises that beset poor households, including death or disability of a breadwinner, illness of family members, natural disasters, or war and conflict. USAID supports different types of providers of retail services, including banks, credit unions, NGOs, and non-bank financial institutions, so that families and businesses benefit from choice and competition. USAID carries out a balanced mix of interventions to achieve the goal of more and better financial services. These measures can include support for capacity building to help retail microfinance institutions become sustainable; for conducting market research and developing new products that will ensure that microfinance institutions provide the services that their clients demand; help for microfinance institutions so they can gain access to commercial capital; and support for technology solutions that can extend outreach and reduce transaction costs.

In some countries with more mature microfinance markets, USAID has shifted its strategy from supporting individual retail institutions to developing the microfinance industry as a whole and the market infrastructure it needs to thrive. This support may entail funding to help multiple providers with new product development, or investments in specialized institutions such as credit information bureaus and ratings agencies. The resulting competition can lead to product innovation, greater efficiencies, and better services and prices for clients. Measures to improve the macro level—financial-sector laws, regulations and policies to create an appropriate enabling environment for pro-poor financial services, and capacity of bank and credit union regulators to supervise microfinance activities and institutions—are often critical at every stage of market development.

Financial services are necessary but insufficient for many enterprises to survive and thrive. Where the poor are not linked into growth opportunities or lack the resources they need to take advantage of opportunities, economic growth translates into poverty reduction much less effectively. USAID has sought to create wealth in poor communities and promote economic growth by linking large numbers of low-income entrepreneurs into better markets and increasing their productivity and competitiveness. This requires sustainable business services, market linkage and market information services, access to improved production technologies, and organization of poorer entrepreneurs to improve their efficiency and bargaining power in the market. It also requires strengthening value chains where the poor are concentrated—often within the agriculture or informal sector—and improving the competitiveness of industries in which significant numbers of micro-scale firms participate.

In some cases, the Agency can accomplish more by changing a regulation or helping implement a law than it can by supporting a single institution to deliver direct services. A supportive enabling environment includes favorable business and investment climates and is critical to successful, sustainable microenterprise development. USAID supports reform of laws, regulations, and policies to facilitate the start-up and growth of microenterprises and to expand access to financial and other services by the underserved poor. Interventions can include helping countries streamline their business registration process, building the capacity of microentrepreneurs to work through independent business associations to advocate for policy reforms, promoting anti-corruption efforts and tax reform, and improving policies and regulations in sectors of particular importance to microenterprises and poorer households.

Question:

Within the FIELD Support LWA, there seems to be a strong emphasis on the enabling environment. Can you explain USAID's rationale for this focus?

Response:

USAID's FIELD Support LWA mobilizes the expertise that the non-profit community offers across all three technical approaches: financial services, enterprise development, and enabling environment; no one technical approach is emphasized over any other. USAID's Office of Microenterprise Development assists missions in developing strategies and programs whose foci reduce the most binding constraints in order to achieve sustainability and maximum impact.

Evidence from FY 2006, the first year that the FIELD Support LWA has been available, confirms that missions have not used this mechanism to focus predominantly on the enabling environment. By the end of this fiscal year, the Microenterprise Development office expects to have obligated nearly $3 million under the FIELD-Support LWA to implement nine pilot projects in Peru, Guatemala, Bangladesh, and throughout Africa. These projects, designed to improve livelihoods and entrepreneurship of the poor, will be implemented through the full range of USAID's microenterprise technical approaches. These projects include integrating the poor into the formal banking sector through remittances, mapping social performance standards to help private social investors invest in microfinance, documenting sound practices for the provision of savings-led financial services, and conducting a health sector assessment. Furthermore, under the FIELD-Support LWA, training will be provided to practitioners to administer the poverty measurement tools. Of all of the projects under the FIELD-Support LWA, developing guidelines for sustainable microenterprise development in fragile states comes the closest to addressing enabling environment issues. The combination of these projects addresses the needs of the poor at all levels: service provision, institutional development, infrastructure development and the enabling environment.

Question:

In light of significant changes at the State Department that are resulting in a country-level focus for programs, there is a danger that global and regional programs requiring a high level of technical expertise may be lost. What is are USAID and the State Department doing to ensure that long-term economic development through the provision of retail microfinance services is maintained as an effective strategy to combat poverty?

Response:

Microfinance and microenterprise development are explicitly included in the new Strategic Framework for Foreign Assistance, appearing among the elements of two objectives: Economic Growth, under the Economic Opportunity area of the framework, and Investing in People, under the Social Services and Protection for Vulnerable People area. We anticipate that support for microfinance and microenterprise development will continue to play a role in long-term economic development programs. The specific form that these programs take will be worked out in Country Operational Plans put together by country teams. EGAT will assist country teams with the specifics of program design.

The new Strategic Framework for Foreign Assistance recognizes the importance of alleviating poverty and making long-term investments in the people and institutions of developing countries. Doing so reflects not only the compassion of the American people, it also improves our security, since poverty, like unjust and oppressive rule, is an underlying condition for breeding terror and instability.

USAID and the State Department agree that true development requires far-reaching, fundamental changes in governance and institutions, human capacity and economic structure, so that countries can sustain further economic and social progress without permanently depending on foreign aid.

Work on the Foreign Assistance Framework is ongoing and moving along on schedule, with Agency and Department-wide staff input into defining the elements of the framework, developing indicators to measure program impact, and so forth.

Updates to the Foreign Assistance Framework are posted on www.state.gov/f.

Question:

Half of U.S. assistance is supposed to be targeted at the "very poor," defined as those in the lower half of people living below the poverty line. Are there difficulties in establishing the specific level of income of individuals living in poverty? What are the problems associated with applying visual indicators, such as type of house or clothing, to help distinguish between those poor people living in the upper half below the poverty line versus those living in the bottom half? In your view, what are the advantages and disadvantages of targeting U.S. assistance to help the "very poor" versus "the poor" or some other group?

Response:

Establishing income levels of poor people in developing countries is extremely challenging, particularly given the mix of cash income, barter and other forms of exchange that constitute their livelihoods. The Microenterprise for Self-Reliance Act defines "very poor" in terms of consumption (those people who are living on less than a dollar a day, or in the bottom half of the population that falls below the national poverty line) rather than income. The poverty measurement tools USAID has developed use a combination of proxy indicators (consumption of goods, household assets, education, head-of-household status and others) to determine the incidence of extreme poverty in a given group of clients.

Even so, with people who are clustered around that cut-off line, it remains very difficult to locate them accurately on one side or the other. Where visual indicators such as housing or clothing type can help to locate people relative to one another, these indicators are incorporated into our poverty measurement tools. Taken alone, however, they do not allow us to determine the cut-off point between those who are just over a dollar a day, or the fifty percent mark, and those who are just under.

Likewise, targeting U.S. assistance to the "very poor" suggests we can meaningfully distinguish between someone at ninety-eight cents a day and someone at a dollar and two cents a day. It is uncertain that this "bright line" distinction reflects a significant difference in the material well-being of potential clients.

Moreover, it is frequently not sufficient to rely only on interventions that are tied to specific client data. USAID support for policy reforms that simplify and shorten the business registration process or render tax policy and enforcement more transparent and fair does help very poor clients, but because this is not measurable, such interventions aren't counted toward the fifty percent target.

The target has advantages, as well. Chief among them is the attention that it focuses on the need for the microenterprise development field as a whole to improve its ability to reach more very poor clients with the products and services they need. However, because the target is expressed in terms that require the tools to focus on distinguishing between those above and below the absolute cut-off point, a great deal of resources have been devoted to achieving that type and degree of accuracy. Those resources might be more effectively directed to supporting the development of new ways to better serve poor and very poor clients.

Question:

In recent years, some microcredit financial institutions which relied entirely on donor aid have been able to become financially self-sustaining by charging sufficient interest and working efficiently. What are the current trends for institutions to become self sufficient? How many are self-sufficient now? Are there regions or countries where this trend is more prominent? What is USAID doing to encourage the process of sustainability?

Response:

In FY 2005, fifty-eight percent of USAID-supported microfinance institutions were fully financially sustainable, compared with thirty-eight percent in FY 2001. USAID agreements with MFIs generally require that the institution have a clear business plan that will enable them to achieve full financial sustainability within seven years of initial funding. MFIs achieve this status through charging market interest rates and increasing their efficiency, but also through engaging in market research and appropriate product design to ensure that the products and services are those that their customers demand, and those that can secure and increase their market share. Outreach to new client groups is another key factor.

USAID promotes sustainability by providing technical assistance for MFIs to increase their efficiency by developing staff capacity, upgrading management information systems and adopting technologies that can expand outreach and reduce transaction costs. We also support market research and product design and development that can increase MFIs' competitiveness; and we link MFIs to sources of private capital so that they can establish themselves in local financial markets and reduce their reliance on donor funding to meet their capital needs. Moreover, by setting and upholding microfinance best practices, USAID ensures that MFIs will be able to attract private commercial capital in the form of equity investments.

I can offer an example of our support for cost-saving technology from the Philippines. In that country, USAID supports a project called Microenterprise Access to Banking Services, which linked the Rural Bankers' Association of the Philippines with Globe Telecom to implement the Text-a-Payment service. This service enables clients to make loan payments using mobile phones. The use of this technology saves clients the money they would otherwise have to spend on transportation to get to the bank to make their payments in person; and it saves them the time they would spend traveling and standing in line at the bank branch. The technology also saved the MFI money that it would have had to pay loan officers and collection agents to complete these transactions.

In regional terms, sustainability figures vary both geographically and from year to year, as the universe of MFIs that receive USAID support shifts. In FY 2005, about sixty percent of USAID-supported MFIs in Latin America and the Caribbean, Asia and the Near East were financially sustainable; seventy percent of MFIs in Europe and Eurasia were financially sustainable; and about thirty percent in Africa were. African MFIs tend to work in more challenging markets where markets are less accessible and populations are poorer and more dispersed.

An example of how MFIs progress toward sustainability can be found in Malawi, where USAID supports the Opportunity International Bank of Malawi (OIBM), which opened its doors to clients in 2003. Starting with 5,000 savings clients in 2003, OIBM reported nearly 43,000 savings clients in 2005 with average savings of $107; more than half of these clients were women. As a microfinance institution, OIBM is building toward sustainability by channeling savings generated in the community into loans, rather than looking primarily to donors to provide loan capital. As loans are repaid, they are recycled into more loans. OIBM started by making approximately 100 loans in 2003; in 2005, the institution reported nearly 5,000 outstanding loans and was already 80 percent fully sustainable.

Question:

What percentage of funding is being used to encourage policy reforms that might improve the enabling environment for microfinance and microentrepreneurs? Please give examples of policy reforms that help microenterprise and what USAID implementers did to bring about those reforms?

Response:

The donor community as a whole is devoting greater attention to the enabling environment, most visibly embodied in the World Bank's Doing Business reports, and careful consideration of the enabling environment is becoming more standard practice in broader enterprise development programs. In FY 2005, USAID supported policy reform activities with eleven percent of its microenterprise funding. These activities are often integrated into broader microenterprise or credit development programs.

East Timor (Timor-Leste) is the world's newest nation and one of the poorest, with 41% of the population living below the national poverty line of fifty-five cents per person per day. With funding from USAID, a group of international and Timorese microfinance organizations formed a powerful alliance to address one of the country's most urgent needs: access to credit for the poor. The Working Group focused on the drafting of a Code of Conduct to set clear standards by which microfinance clients, donors and the Government of Timor-Leste can hold practitioners accountable.

In signing the Code, the Working Group became one of the few microfinance associations in the world to do so. Along with the Code, the Working Group, led by a USAID-funded team, established a Joint Reporting Format, which they used as a basis for selecting key indicators for a Performance Monitoring System. The Performance Monitoring System that the team developed will enable practitioners to measure the performance of the sector over time and to benchmark their performance against others in their category, providing valuable information for public consumption.

The Code of Conduct, Joint Reporting Format, and Performance Monitoring System enhance transparency and promote accountability for the nascent microfinance industry in Timor-Leste. They enable practitioners to work together to build a strong microfinance industry to alleviate poverty and promote sustainable economic growth.