Gary Woller: Written Congressional Testimony – Observations on the Implementation of the Microenterprise Results and Accountability Act of 2004"

Statement of Gary Woller, President, Woller & Associates

Written Testimony before the Subcommittee on Africa, Global Human Rights and International Operations, U.S. House of Representatives

Hearing on "Reviewing the Progress and Charting the Path Ahead: The Microenterprise Results and Accountability Act of 2004"

July 27, 2006

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.