IMPLEMENTING 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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IMPLEMENTING THE MICROENTERPRISE RESULTS AND ACCOUNTABILITY ACT OF 2004

TUESDAY, SEPTEMBER 20, 2005

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 2:05 p.m. in room 2172, Rayburn House Office Building, Hon. Christopher H. Smith (Chairman of the Subcommittee) presiding.

Mr. SMITH OF NEW JERSEY. The Committee will come to order, and I want to wish a good afternoon to everyone and welcome my former colleague—I don't know if he is still in the room—Dan Mica, who was here earlier; we served together in the House Committee on Veterans' Affairs. And he was here earlier. I guess he had to leave.

Welcome to this hearing of the Subcommittee on Africa, Global Human Rights and International Operations. Today we will be examining the implementation of Public Law 108–484, the Microenterprise Results and Accountability Act of 2004.

Earlier this year, I traveled along with some of my other colleagues to coastal areas in Indonesia, Thailand, and Sri Lanka which had been devastated by the tsunami. The destruction from those 50-foot-high waves was almost total, as we all know, and the vast majority of individuals affected were fishermen and other working poor whose boats and nets and livelihoods had been completely swept away. While they gratefully received the emergency food aid and shelter which our military and our USAID disaster relief team so efficiently provided, in the medium term, what these folks really needed and wanted was a small loan to enable them to rebuild their businesses and become self-sufficient once again.

The same could be said of areas in our own country which have been devastated by Hurricane Katrina. While I am not aware of any microloan programs operating in New Orleans, having read Dr. Morduch's testimony, which he will give later today, I do know that a microcredit group, Accion New York, serves over 6,000 customers in the New York metropolitan area.

Whether here or abroad, I have long been a fan of microcredit programs because I have seen them work. While the term "foreign aid" often has a bad connotation, although it shouldn't but it does at times, and there are some good reasons why, many times in the past foreign aid was delivered in a top-down manner to corrupt

governments and organizations, where it never really reached the intended recipients.

Microcredit, on the other hand, takes a totally different approach. It is a trickle-up approach that focuses on helping the poorest people on the planet build themselves up once again little by little into self-sufficiency by giving them access to financing. The success of microenterprise lending programs to empower entrepreneurs and borrowers in the developing world cannot be overstated.

Over 2 million clients are currently benefiting from USAID-assisted programs that provide the necessary capital through small loans, usually of a few hundred dollars or less, for entrepreneurs to start and expand their own small businesses. It is estimated that 97 percent of the microenterprise loans are successfully repaid and 70 percent go to women who are often very vulnerable, subjected to abuse, and in need of economic opportunities in the developing world. Microenterprise is a key vehicle to assist victims of trafficking and to raise the social and economic status of women around the world.

Microenterprise also complements the principles that President Bush has outlined for more effective foreign aid through the Millennium Challenge Account and is a key component for fulfilling the U.N.'s Millennium Development Goals to eradicate world poverty by the year 2015. Business owners assisted by micro-lending are not only able to increase their own incomes, but through their own efforts, they create jobs and help economies grow.

Success stories from the beneficiaries of microenterprise are quite numerous. Take, for example, Dorothy Eyiah from Ghana. Dorothy was resourceful, but she had no idea how she was going to support her AIDS-stricken sister and family when she brought them into her home in Ghana. She used to support herself selling ice, but that wasn't going to pay for the food and medicines she now needed. She started praying. All doors seemed shut until Dorothy met some women within her village who are part of an Opportunity International Trust Bank. The Trust Bank could help her grow a small business, providing her with financing, training, and support. Five loans later, Dorothy is the secretary of her Trust Bank and runs three businesses, employing nine people from her village. She is content, her sister is comfortable, all the children are in school, and their needs are being met. "God has been so good to me," she says.

Success stories such as this are what microfinance and the Microenterprise Results and Accountability Act of 2004 are all about. By building the best possible microenterprise program, we will be able to reach the greatest number of people, poor people, with services that truly will have an impact on their lives. As we compare the effectiveness of various methods of implementing microcredit programs, success will be measured by the ability to reach very poor people and other underserved populations, including women, and by the kind of impact these programs have on poor families. We are concerned not only with the efficient delivery of financial services but also with the well-being of those who receive those services. We want to see poor people work their way out of poverty, increase their incomes, build their assets, and grow their

businesses, and we also want to see them educate their children, achieve greater self-esteem, strengthen their families, and improve the quality of their lives.

I introduced the Microenterprise Results and Accountability Act of 2004 at the beginning of the 108th Congress, and the final product represents the culmination of months of hard work and discussion by Republicans and Democrats alike in both the House and the Senate, members of the microenterprise community, and USAID to build upon one of our most progressive and successful foreign aid programs.

This legislation is primarily about ensuring better results, not authorizing additional money, although we would all like to see that. A comprehensive GAO report completed in November 2003 revealed that oversight and accountability of microenterprise programs administered by USAID is weak, and that programs are not having the desired effect of reaching the very poor, those earning less than the equivalent of $1 a day, to the greatest extent possible.

In response to these concerns, Public Law 108–484 builds in accountability through a focus on cost effectiveness and efficiency. The law establishes a dedicated Microenterprise Office within USAID, which will approve strategic plans of field missions, establish a monitoring system in order to maximize the impact of programs and measure results, and coordinate preparation of a yearly report to the Congress. The legislation also ensures that more funds go to the very poor through the development and implementation of easy-to-use, cost-effective poverty assessment techniques. Identifying and targeting the poorest potential clients who could stand to benefit most from microenterprise loans has proven to be more difficult than originally anticipated. I am hopeful that, once developed, these poverty assessment techniques may prove useful not only for microenterprise but also in other areas of our foreign aid.

Public Law 108–484 also stipulates that USAID should emphasize the use of global microfinance networks and other nonprofit private voluntary organizations in the implementation of microenterprising and microfinance programs. In the last 2 years, I am concerned that USAID has been shifting its focus away from nonprofit organizations and networks to contractors in the implementation of the Agency's Microenterprise Program.

While for-profit entities such as consulting firms are making excellent contributions in the areas of technical assistance, research, and policy reform, global microfinance networks and nonprofit private voluntary organizations have the operational experience and track record in microenterprise and microfinance service delivery to poor people. These organizations are able to get resources directly to clients and are well-positioned to reach the very poorest economically active entrepreneurs in the countries where they work. Further, such networks have built self-sustaining microfinance institutions that now cover, on average, almost all of their operating costs. More than $150 million in earned revenue was captured by these institutions in 2002 to cover their operating costs, in addition to private donations that have added significant leverage to USAID's investments. These networks have excelled in rapidly developing microfinance institutions in volatile and risky situations,

including during the early stages of a country's transition from war to peace.

I look forward to a good and vigorous discussion in today's hearing about these important issues. Yet as we debate and discuss, I hope we remember our common concern to equip those who want to escape from poverty with the tools to build a better life. For when we provide microcredit loans to the developing world, and as we do it, we export our values upon which our Nation was based, including the idea that if you work hard and dream big you can indeed succeed.

[The prepared statement of Mr. Chris 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, and welcome to this hearing of the Subcommittee on Africa, Global Human Rights and International Operations. Today we will be examining the implementation of PL 108–484, the Microenterprise Results and Accountability Act of 2004.

Earlier this year, I travelled to coastal areas of Indonesia, Thailand, and Sri Lanka which had been devastated by the tsunami. The destruction from those 50-foot high waves was almost total, and the vast majority of individuals affected were fisherman and other working poor whose boats and nets and livelihoods had been completely swept away. While they gratefully received the emergency food aid and shelter which our military and our USAID disaster relief teams so efficiently provided, in the medium term, what these folks really needed and wanted was a small loan to enable them to rebuild their businesses and become self-sufficient again.

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Whether here or abroad, I have long been a fan of microcredit programs because I have seen them work. The term "foreign aid" often has a bad connotation—and there are some good reasons why, too. Many times in the past, foreign aid was delivered in a top-down manner to corrupt governments and organizations, where it never really reached the intended recipients.

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I look forward to a vigorous discussion at today's hearing about these important issues. Yet as we debate and discuss, I hope we remember our common concern to equip those who want to escape from poverty with the tools to build a better life. For when we provide micro loans for the developing world, we export values upon which our nation is based upon, including the ideal that if you work hard and dream big, you can succeed.

I turn now to my good friend and colleague, Mr. Payne, for his opening remarks.

Mr. SMITH OF NEW JERSEY. I understand that our Ranking Member, Don Payne, will join us at approximately 2:30, but I would like to turn to Mr. Fortenberry, a Member of the Committee, for any comments he might have.

Mr. FORTENBERRY. Thank you, Mr. Chairman. No extended comments at this time other than to thank you for holding this most important hearing on this very relevant topic on microenterprise and microfinance, and to thank you for your attentiveness to the details of the particular act in question. This is so essential in meeting the needs of the poor and empowering people to help themselves. We can always find creative ways to enter into conflict, but it is also important to find creative ways to build good relationships, and I am so impressed by the variety of players worldwide that have latched on and wedded the best ideals of free market capitalism to empower the poor to take care of themselves. And this is a very, very important foreign policy goal that I would think fits very well into our overall foreign policy goals.

So thank you, Mr. Chairman, for holding this hearing.

I would like to add, do you like my tie? This comes from a microenterprise in Ghana. So?

Mr. SMITH OF NEW JERSEY. Good thing I said yes. How about the suit?

Mr. FORTENBERRY. Nebraska.

Mr. SMITH OF NEW JERSEY. Thank you very much, Mr. Fortenberry, for your work on this Committee and for your concern about microenterprise and microfinance.

I would like to introduce our first distinguished witness to the Committee, James Smith, who was named as Deputy Assistant Administrator for Economic Growth, Agriculture and Trade of the U.S. Agency for International Development (USAID) in 2003. He has been the Acting Assistant Administrator since March 2005. A member of the Senior Foreign Service, Mr. Smith has more than 28 years of experience in international development. From 1998 to 2003, he served as USAID Director of Development and Planning in the Africa Bureau, where he led strategic planning and resource allocation for USAID's program in Africa. From 1994 to 1998, James Smith was Deputy Director for USAID's mission in Mozambique where he oversaw an aid portfolio of more than $60 million annually and a mission staff of over 100 employees. From 1989 to 1994, he served as the Africa Bureau's senior economist, traveling widely throughout Africa in support of USAID mission programs. Mr. Smith also served as program economist for USAID's mission in Morocco from 1983 to 1989 and in Burkina Faso from 1978 to 1983. James Smith began his career as a Peace Corps volunteer in 1969.

Mr. Smith, if you could proceed as you would like.

STATEMENT OF MR. JAMES T. SMITH, ACTING ASSISTANT ADMINISTRATOR, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. SMITH. Thank you very much, Mr. Chairman and Members of the Subcommittee, for the opportunity to appear before you today and to discuss implementation of the Microenterprise Results and Accountability Act of 2004.

The United States Agency for International Development has moved vigorously to implement the new microenterprise law, and I will outline the specific steps we have taken. To put these implementation measures in their proper context, however, I would like to begin with an explanation of how USAID defines and pursues its goals in microenterprise development and microfinance. I respectfully request, Mr. Chairman, that my entire written statement be included in the official record of the hearing.

Mr. SMITH OF NEW JERSEY. Without objection, it will be made a part of the record.

Mr. SMITH. Thank you.

Speaking before the United Nations last Wednesday, President Bush stated that "We must defend and extend a vision of human dignity, and opportunity, and prosperity. . . . To spread a vision of hope, the United States is determined to help nations that are struggling with poverty."

This commitment on the part of the United States Government is a longstanding one. For the past three decades, support for microenterprise development has been an important feature of this commitment. In this era of globalization, generating economic growth in developing countries while reducing poverty is not only 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 fragile states and key strategic partners of the United States.

As the leading bilateral donor for microenterprise development, USAID has advanced a vision of increasing economic opportunities for poorer households and businesses to enable these families and businesses to build assets, cope with risks and vulnerability that accompany poverty, and plan for better futures for their children. USAID's strategies support delivery of effective financial and business services that poorer families and entrepreneurs need to succeed as well as policy changes that reward initiative and hard work.

Over the past 5 years, from 2000 to 2004, USAID's average annual funding for microenterprise development has been over $178 million, and it is projected to exceed $200 million in fiscal year 2005. This support has reached nearly 4 million microenterprises annually.

The Agency's high impact investments in microenterprise development over the past three decades have earned it recognition as a leader in the field. In the microfinance field, USAID recently received a top rating overall and a top rating specifically in accountability in peer reviews of 17 donor programs. These reviews were organized by the Consultative Group to Assist the Poor, known as CGAP, a 28-donor partnership that develops industry standards and identifies and promotes best practices in microfinance. The Agency's reputation as a leader and innovator is further evidenced by its embodiment of key principles contained in the *Donor Guidelines on Good Practice*, published last February by CGAP. And we have these reports available for the Committee.

Examples include our practice of supporting diverse retail providers of financial services; for example, banks, credit unions, NGOs, nonbank financial institutions, supporting a balanced mix of

interventions, including micro, meso/market, and macro/policy levels, insisting on sustainability, phasing out grant funded loan capital as soon as feasible, and encouraging leverage of private resources. And I have some examples I can talk about at some point if you would like.

Further, our programs are also responsive to the action plan for harnessing entrepreneurship to eradicate poverty, recently adopted by the Group of Eight (G–8) leading industrialized nations at the 2004 Sea Island Summit.

USAID's investment in implied research, experimentation, tools development, and dissemination enables the Agency to identify and seize new opportunities, develop innovative interventions, and improve investments in capacity building and direct service delivery that contribute to efficiency, cost effectiveness, and sustainability. These three goals were identified in Public Law 108–484 that we are discussing today.

As reported previously, the Agency has undertaken a range of measures to comply with the law. We have established an Office of Microenterprise Development and increased its budget commensurate with its new responsibilities. Its fiscal year 2005 budget of $20 million is more than a third larger than its fiscal year 2004 budget level. We have initiated new programs, including central programs designed specifically to strengthen our relationship with our PVO partners and link them to mission programs. We have also enhanced our results reporting system in order to capture systematic data on funds subobligated from primary recipients to other partners, often nonprofits, and we will report on this in detail beginning in our report on fiscal year 2005 activities.

In the interest of time, I will comment on the most significant steps USAID has taken to implement the new law, and I welcome follow-up questions on other areas of interest to Subcommittee Members.

With respect to continuing our support to PVO networks, the Microenterprise Development Office will be releasing two Requests for Applications, worth $10 million, for the Implementation Grant Program in the next month. These are focused on delivery of financial services enterprise development. The Agency has designed the new microenterprise Leader With Associates mechanism, with funding planned at $10 million over 5 years. And that is the central office funding. It also permits missions to buy into this agreement with up to $340 million over the next 5 years to mobilize the expertise of the nonprofit community as a means to achieve the policy goals reflected in the law. Additional grant competitions, with funding of roughly $2 million, will support learning among microfinance and microenterprise practitioners, innovations in reaching underserved populations, and linking small producers to supermarkets. This array of grant competitions 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.

The additional reporting requirements in the new law will lead to other enhancements to microenterprise results reporting as well. These enhancements will enable us to analyze and report on the comparative cost effectiveness and sustainability of projects carried

out under these various mechanisms, efforts regarding trafficking of persons and women who are victims of or susceptible to other forms of exploitation and violence, an estimate of the percentage of beneficiaries of assistance under this title in countries where a strong relationship between poverty and race or ethnicity has been demonstrated, and the estimated percentage of assistance allocated to the very poor and the estimated number of the very poor reached with assistance.

These analyses and reporting systems will permit us to comment in more depth in the June 2006 report to Congress on the nature and amount of support to specially disadvantaged populations. They will also form the basis for reporting on the comparative advantages of different kinds of implementing partners and other program design and implementation issues related to the policy goals of cost effectiveness, efficiency, and sustainability that are of critical importance to USAID and have been underscored in the microenterprise law.

In sum, USAID has moved vigorously to implement the new microenterprise law and made much progress on each of its key provisions. We are committed to continuing to do so in close consultation with Congress and our implementing partners. I am happy to answer additional questions you have about the Agency's implementation of Public Law 108–484.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF MR. JAMES T. SMITH, ACTING ASSISTANT ADMINISTRATOR, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to appear before you today to discuss implementation of the Microenterprise Results and Accountability Act of 2004. The United States Agency for International Development (USAID) has moved vigorously to implement the new microenterprise law, and will outline the specific steps we have taken later in this statement. To put these implementation measures in their proper context, however, I would like to begin with an overview explanation of how microenterprise development and microfinance contribute to USAID's evolving roles in promoting economic growth with poverty reduction around the world, and the strategy USAID pursues to achieve these goals. I will also present observations on the extent to which we are succeeding in this work, and emerging issues in program design and implementation.

INTRODUCTION

Speaking before the United Nations last Wednesday, President Bush stated that "We must defend and extend a vision of human dignity, and opportunity, and prosperity. . . . To spread a vision of hope, the United States is determined to help nations that are struggling with poverty." This commitment on the part of the United States government is as long-standing as it is laudable. It is also challenging. For the past three decades, support for microenterprise development has been an important feature of U.S. foreign assistance. In this era of globalization, 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 fragile states and key strategic partners of the US.

As the leading bilateral donor for microenterprise development (which includes but is not limited to microfinance), USAID has advanced its vision of strengthening 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. The Agency'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 FY2004, USAID's microenterprise funding reached $180 million and is projected to exceed $200 million in FY2005. This support currently reaches more than 3.85 million entrepreneurs and households worldwide. Their economic activities include producing goods for export, such as footwear, furniture, or food and other agricultural crops; providing services ranging from equipment repair to information technology; marketing raw materials to manufacturers; producing goods and services for their communities and larger businesses; and trading a wide variety of goods. As these businesses expand and integrate into the formal economies of their countries, they empower the world's poor, create higher incomes and more jobs, contribute to economic growth, and strengthen democratic societies.

LEADERSHIP AND INNOVATION

The Agency's high-impact investments in microenterprise development over the past three decades have earned it recognition as a leader in the field. In the microfinance field, USAID recently received a top rating overall and a top rating specifically in accountability in peer reviews of 17 donors' effectiveness in carrying out microfinance activities worldwide. The reviews were organized by the Consultative Group to Assist the Poor (CGAP), a 28-donor partnership that develops industry standards and identifies and promotes best practices in microfinance. Among the participating donors, which included bilaterals, development banks and multilaterals, USAID received top ratings in staff capacity, accountability for results, and appropriate instruments, and received high ratings as well in knowledge management and strategic clarity. The peer review ratified the Agency's multifaceted strategy, noting that "USAID has largely contributed to the field by funding some of the most prominent microfinance institutions (or MFIs) and networks (such as [Bank Rakyat Indonesia], Grameen replications, ACCION, FINCA, Banco Ademi, the World Council of Credit Unions, etc.) and by launching research programs that have produced significant knowledge and become public goods for the international community." The report concludes that "With over 25 years of experience, USAID rightly describes itself as a pioneer and a leader in the field of microfinance."

The Agency's reputation as a leader and innovator in the field of microfinance is further evidenced by the fact that our work embodies the key principles contained in the "Donor Guidelines on Good Practice," published last February by CGAP. Examples include our practice of supporting diverse retail providers of financial services (e.g., banks, credit unions, NGOs, non-bank financial institutions), supporting a balanced mix of interventions (on the micro, meso/market, and macro/policy levels), insisting on sustainability, phasing out grant-funded loan capital as soon as feasible, encouraging leverage of private resources, etc. Further, our programs also substantially embody the core microfinance principles recently adopted by the Group of Eight (G8) leading industrialized nations at the 2004 Sea Island Summit.

In the area of expanding opportunities for micro and small enterprises, USAID is also recognized as a leader and innovator. USAID was one of the first donor agencies to embrace the principle that business services must be sustainable and demand-driven, so they respond to market signals and can be scaleable. USAID enterprise development programs rely substantially on private-sector, commercial firms to offer relevant services to smaller entrepreneurs and link them into improved markets on favorable terms. Our recent work to strengthen key value chains—such as dairy and horticulture in Kenya, handicrafts in Guatemala and Peru, specialty apparel in Pakistan and Brazil—in which poorer entrepreneurs can participate effectively, is widely recognized by other donors as pioneering. Other donors have asked USAID to take the lead in developing improved ways to evaluate the impacts of diverse enterprise development programs on businesses, families, communities, and economies.

USAID's leadership in microenterprise development is also well established in identifying and disseminating best practices, and generating knowledge and tools for practitioners. This investment in applied research, experimentation, tools development, and dissemination enables the Agency to identify and seize new opportunities, to develop innovative interventions, and to improve investments in capacity building and direct service delivery that contribute to efficiency, cost-effectiveness and sustainability—three goals identified by PL 108–484.

MICROENTERPRISE DEVELOPMENT IN THE 21ST CENTURY

USAID Administrator Andrew Natsios stated in USAID's White Paper, *U.S. Foreign Aid Meeting the Challenges of the Twenty-first Century*, that today, we are wit-

nessing the most significant shift in awareness and understanding of international development that's been seen since the end of World War II. The demise of the Soviet Union, the integration of global communications and markets, the growing menace of global terrorism, weapons of mass destruction and transnational crime, the surge of HIV/AIDS and other infectious diseases—all these are hallmarks of an altered 21st century landscape for development.

As we have revised the Agency's strategies and programs to strategically align U.S. foreign aid resources and accountability with the various and distinct objectives of foreign aid, we have also identified opportunities for microenterprise development and microfinance to contribute to each objective. These include support for especially disadvantaged populations that have experienced trafficking, natural disasters, HIV/AIDS, and conflict. Our efforts in these areas are further discussed below, in the section on "Expanding the Reach of Microenterprise Development."

Globalization is one critical factor shaping the opportunities for growth and poverty reduction in developing countries. Driven by international trade, spurred by liberalization and aided by technology, globalization has propelled competitiveness on a world scale. Whereas historically, firms have tended to compete against other firms in the same country, with globalization, industries in one country are competing against the same industry in another country. As a result, firm-level competitiveness is no longer sufficient, if the firm is situated in an industry or value chain that is weak. Consequently, donors concerned about growth that reduces poverty must focus not only on directly improving performance of the small and very small firms that the poor own and operate but also on the performance of industries in which large numbers of the poor participate.

Growth is an essential requirement and, frequently, is the main contributing factor in raising the average incomes of the poor. However, the extent to which growth reduces poverty varies dramatically, depending on the level of inequality to start with and the extent to which the poor are able to participate in and benefit from the growth process. In those countries where the poor are not linked into growth opportunities or where they lack the resources with which to take advantage of existing opportunities, economic growth translates into poverty reduction much less effectively and efficiently than in countries where the poor are linked to growth opportunities and have the means to respond to those opportunities. Conversely, where the poor are linked to growth processes, growth is more likely to be sustainable.

USAID has sought to create wealth in poor communities and promote economic growth by linking large numbers of micro and small enterprises (MSEs) into productive markets on a sustainable basis. USAID programs around the world help to link MSEs into global and domestic value chains, while addressing the constraints these small firms face in competing in more lucrative and sophisticated markets. Small firms benefit from participation in a global economy in certain situations and under certain conditions. After identifying those conditions, we can target sectors where the poor are concentrated—often within the agriculture or informal sector—and aim to improve the competitiveness of industries in which significant numbers of micro-scale firms participate.

The critical contribution of access to finance in promoting economic growth with poverty reduction is increasingly well-understood. Particularly in poor countries, interventions to increase access of poor households to diverse financial services—credit, savings, insurance, remittance and payment services—are powerfully associated with growth overall, and with growth that has broad-based benefits. Financial services permit poor households to invest—in their businesses and livelihoods, in their children's education, in housing, in protecting family members' health—thereby increasing not only income but assets that generate long-term returns. The long and complex road out of poverty requires not just increased incomes, but growth and diversification of assets. Financial services also can help protect households from the ever-present risks that poverty brings—death or disability of a breadwinner, extended illnesses, drought and natural disaster, conflict. This protection benefit can help near-poor and once-poor households avoid slipping backwards when adversity strikes, as well as preventing destitution among working poor families.

For all these reasons—growth, poverty reduction, social protection—USAID has long been a major investor in microfinance. We have built institutions that currently provide millions of low-income entrepreneurs and households with diverse financial services. As the microfinance field and our work have matured, we have come to embrace a more ambitious vision. It is no longer sufficient that the poor have access to services from sustainable microfinance institutions. We now seek to help create inclusive financial markets that serve the poor majority in developing and transition countries. This requires carefully-designed investments that build strong retail institutions specializing in microfinance, that attract mainstream financial institutions

into this market, that build the market infrastructure required for pro-poor finance to thrive, and that ensure policy environments that are favorable to this vision.

USAID'S VISION FOR MICROENTERPRISE DEVELOPMENT

USAID's assistance programs seek to broaden economic opportunities for poor and very poor entrepreneurs and households to help them build assets, cushion the impact of financial shock, and contribute to key sectors of local, national and regional economies. Such assistance is a critical aspect of our work to achieve the Agency's objective of spurring *economic growth with poverty reduction.*

Over the course of almost three decades, USAID has developed and adapted a wide range of innovative strategies, programs and tools. The three interrelated components of our strategy in this field comprise enterprise development, microfinance, and policy, regulatory and legal reform.

Congress recognized the validity of these strategy elements in PL 108–484, which *authorizes a comprehensive package* of assistance that includes training, technical assistance, capacity building, and research to expand the availability of credit, savings, and business development services, and to extend the reach of programs aimed at improving policy and regulatory environments for microenterprises.

Enterprise development

Low-income entrepreneurs need assistance in linking into better markets and increasing their productivity and competitiveness. This requires sustainable business services, market linkage services, access to improved production technologies, and organization of poorer entrepreneurs into groups to improve their efficiency and bargaining power in the market. It also requires strengthening value chains that are particularly important to poorer entrepreneurs.

In the words of Ela Bhatt, Founder of the Self Employed Women's Association (SEWA) in India, which has a membership of 687,000 women:

> "Poor people put savings and credit to good use in building their assets, incomes and social welfare. At the same time, it is increasingly clear that access to financial services alone will not be enough for poor people to transform their businesses into more profitable economic activities. Many poor people who are self-employed and in the informal sector are operating in saturated markets. With increasing globalization, the poor need access to markets, information, technical know-how, and other supporting services if they are to share in economic growth."

To increase opportunities for enterprises owned and operated by low-income people, USAID carries out the following kinds of activities:

- Promoting the development of competitive value chains in sectors important to smaller entrepreneurs, and supporting the linkage of micro and small firms into these chains on favorable terms. Opened up new market opportunities, including export, for these value chains.
- Supporting upgrading microbusinesses' capacity (through new production techniques, technology, quality control systems, etc.) so they can improve their performance and meet the standards of the new markets in which they are operating.
- Testing and implementing sustainable "win-win" models for larger "lead firms" to deliver effective services and support to the smaller firms that supply them with goods and services.
- Aggregating microbusinesses into groups, including cooperatives and clusters, to increase their ability to fulfill larger orders and their bargaining power in the market.
- Promoting the development and replication of sustainable models for delivering business services, particularly by commercial service providers.
- Facilitating the development of competitive business service markets with competition among providers to offer diverse services to smaller firms.
- Supporting organization of micro and small businesses to advocate for their interests with policy makers, municipal authorities, government agencies, chambers of commerce made up of larger firms, etc.

Examples of our work in this area are illustrative of the potential impact of this approach.

- USAID helped entrepreneurs in Peru boost sales of their products by $78 million, helping create almost 40,000 jobs. The Proyecto de Reduccion y Alivio a la Pobreza (PRA) created demand for local products, including showcasing

red quinoa, a high-protein staple of the Andean diet, at a U.S. restaurant association trade show and Peruvian ceramics to the High Point Furniture Market in North Carolina. The Peruvian products were a hit, landing lucrative contracts worth millions of dollars for local businesses and entrepreneurs. [ ]

- USAID helps microentrepreneurs obtain vital technologies they need to scale up their businesses and enter more profitable markets, such as micro-irrigation kits, food processing equipment, and information technology. For example, in 2001, USAID and International Development Enterprises India brought drip irrigation technologies to subsistence farmers in Maharashtra. Local farmers were able to transition from subsistence to cash crop farming—horticulture to serve growing demand from urban consumers—and realized income gains of $200–400 each per year.
- In Haiti, 37 coffee-grower associations representing 25,000 small growers received USAID support to develop a common logo for the "Haitien Bleu" premium coffee brand. Backed by consistent quality standards and a targeted market, Haitien Bleu has provided the micro producers returns significantly higher than they previously were receiving for coffee harvests without quality controls and premium designations. In Bolivia, USAID funds supported technical assistance to a group of coffee producers and helped build coffee preprocessing plants in producer communities to improve the consistency of coffee quality, contributing to the success of over 20,000 small coffee producers. Bolivia's coffee sector continues to expand and export specialty coffee to large buyers such as Starbucks.
- In Bangladesh, the USAID-supported JOBS program supports firms producing hand-made sandals for export to Paris. With project assistance, the larger exporters organized groups of smaller producers to supply this market, providing them with inputs, designs and quality control in addition to export services. The business services facilitated by JOBS helped flexible, labor-intensive micro-firms enter emerging niche markets for which larger firms are less well suited. The micro firms also used the learning they received from exporters to develop and sell a product for the domestic market, thereby further increasing their incomes. As a result, individual microentrepreneurs working as part of a cluster saw income increases ranging from Taka 2000–5000 ($40–$100) per month, depending on their skill level.
- With USAID support, World Education (WE) in South Africa has initiated a program to help micro and small construction firms owned by previously disadvantaged individuals (PDIs) to benefit from the countrywide construction boom and the South African government's mandate that contractors building for the government subcontract work to PDI-owned businesses. WE stimulates the market for business support services such as information about bidding opportunities, skills in bid preparation and job costing, access to finance to procure inputs and pay workers during contract implementation, and improved operational and technical skills. One of WE's most successful initiatives is the Access to Resources Seminar series that promotes interaction between support service providers and micro- and small-scale contractors, spreading awareness about services and service delivery models to stimulate replication. Micro and small businesses together account for close to 87,000 of the 90,000 firms in South Africa's construction sector, which generates nearly a third of the country's GDP.
- With USAID support, beginning in 2002 the Mennonite Economic Development Associates (MEDA) and its local (Pakistan) partner, the Entrepreneurship and Career Development Institute (ECDI), have been implementing a project called "From Behind the Veil" to help home-bound women embroiderers in three conservative areas of rural Pakistan link to urban wholesalers and retailers. MEDA and ECDI are developing a women-to-women sales network whereby sequestered women are able to reach higher value markets through mobile women intermediaries to expand both the growth of the sector and the income of the individual microenterprise clients. The project is currently working with thirty-six female intermediaries who are actively receiving and selling orders from over 1600 rural embroiderers and 80 urban garment makers. By the end of project implementation, these figures are expected to reach 70 intermediaries and over 6,000 producers. The majority of women in the program have already seen their income double as a result of their participation. By mainstreaming these women into project activities, MEDA and ECDI have effectively reduced gender inequalities in access and control of value chain activities while at the same time respecting and adapting to existing cultural norms.

- Since 1999, USAID-Haiti has supported Aid to Artisans, a U.S.-based NGO, to create economic opportunities for poor artisans. New market linkages between Haitian microenterprises and large-scale buyers such as Pier One have resulted in more than 2,500 long-term jobs and 11,000 short-term jobs.

Financial services for poor households and enterprises

Low-income entrepreneurs also need financial services to meet diverse business needs—credit for working capital and investment, savings, 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, etc.) for non-enterprise purposes—to help them cope with the emergencies and other crises that beset poor households (death or disability of a breadwinner, illness of family members, natural disasters, war and conflict, etc.), to invest in education and other human capital, to build assets such as their home, to smooth consumption when times are lean, and to plan for weddings, funerals, other rituals and celebrations, and old age.

USAID has been a leader worldwide in supporting the creation of sustainable financial institutions capable of delivering the variety of services that poorer households and their enterprises require. USAID's hundreds of partners in this work have built strong NGO microfinance institutions, credit unions, specialized microfinance banks, and non-bank financial institutions. Often, the first challenge is to demonstrate that microfinance can work—that the poor can take and repay loans, that the poor can and do save, that financial services can be delivered profitably to groups long considered unbankable. This may involve comprehensive support for "market leaders," well-managed financial institutions that show what is possible and prepare the ground for other players to enter. In some countries it has proven possible to transform sleepy or poorly-performing credit union movements by helping "model credit unions" modernize and add demand-driven microfinance services.

As the viability of microfinance is established, USAID may continue to support market leaders, in a more focused way, while encouraging the entry of new institutions interested in this market, such as mainstream banks or insurance companies. The early market leaders, which in many cases have been NGOs, might benefit from assistance to access private capital to finance their growth once they are profitable, and to transform to a regulated legal structure if the opportunity presents itself and offers an avenue for substantially improved and scaled-up services. There may also be opportunities to support the transformation of failing state-owned banks—with their enviable network of branches and deposits but weak credit portfolios—into effective providers of microfinance.

As microfinance markets mature and get more competitive, USAID needs to be attentive to the danger of distorting the market, by providing extensive assistance to one or two players to the disadvantage of others that might have creative ideas for extending services to the unbanked. The focus might shift from large-scale support to market leaders to more targeted assistance aimed at supporting development of new financial services and finding new ways to reach underserved markets such as remote rural areas, very poor households, or growing microenterprises that have outgrown the typical microcredit offerings. Application of technologies—for example, through Global Development Alliance partnerships with global IT or financial services companies—might offer promise to increase the efficiency, profitability, and client responsiveness of microfinance institutions. Partial guarantees offered through USAID's Development Credit Authority (DCA) have proven useful in leveraging new private capital into the market, e.g., by sharing risk with mainstream banks "downscaling" their products to serve poorer clients or lending to microfinance institutions.

Comprehensive "umbrella programs" (described in more detail in the section of this statement describing USAID's implementation of the new law) that are designed to build the broader microfinance industry are often appropriate at this stage. In addition to strengthening the diversity of retail financial institutions, such programs can support interventions at the meso and macro levels that are necessary to dramatically expand the availability and diversity of financial services for low-income markets. Examples of meso-level work include efforts to build the capacity of local consultants, auditors, ratings firms agencies, or training institutions or to create or strengthen credit information bureaus, that help all lenders in the market manage their risks and expand their offerings. 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.

In sum, USAID has pursued a comprehensive strategy of support for microfinance, drawing on hundreds of diverse implementing partners. To ensure cost-effectiveness and strong impacts, it has learned to tailor its assistance to be appropriate to specific local conditions and needs, as well as the stage of development of financial markets. Among the specific activities it has supported, as authorized by PL 108–484 and earlier legislation, are the following:

- Supporting the start-up and expansion of strong, sustainable retail institutions to deliver diverse financial services to poorer households and enterprises
- Supporting market research and new product development processes to help our partners develop a greater variety of demand-driven services,
- Encouraging the entry of new players, such as banks, to deliver financial services once the viability of microfinance had been sufficiently demonstrated
- Supporting MFIs to gain access to private capital (domestic and international) to expand their services, including through innovative DCA support for guarantees of loans, bonds, and investment funds targeted to microfinance expansion.
- Supporting the development of service providers to MFIs, including international and local technical assistance providers, auditors, ratings firms, national microfinance associations, etc.
- Supporting the development of new technology solutions to diversify MF services, strengthen MF operations, and facilitate access to capital
- Improving microfinance laws, regulations, and supervision capacity.

Some examples illustrate the results of this support:

- USAID's Microenterprise Development office began supporting WISDOM, World Vision's Ethiopia microfinance affiliate, in October 2001 through its Implementation Grant Program (IGP). As of December 31, 2004, WISDOM's outstanding 6,757 loans were worth $2.162 million and WISDOM was serving 19,912 people, 42 percent of whom were women. The businesses growth enabled by the loans these women secured helped them to provide their families with protein-rich foods such as meat and eggs. Female clients were also significantly less likely to require food aid, which suggests that WISDOM's programs succeed in reducing vulnerability to prolonged drought and food insecurity.
- Eighty percent of the Democratic Republic of Congo population lives in poverty. Recognizing the opportunity embodied in a more secure financial environment, in September 2002, MD awarded FINCA $1.2 million through the competitive Implementation Grant Program (IGP) to launch a village bank program. Today, FINCA DRC's loan portfolio counts more than 7,000 clients with an outstanding loan portfolio of $630,000.
- Today, the Agricultural Bank of Mongolia, now known as Khan Bank, is the leading provider of financial services to rural Mongolia (with the largest rural branch network), one of the largest taxpayers in Mongolia, and the most profitable of the 16 major Mongolian banks. But just five years ago, Ag Bank was in receivership and facing possible liquidation after more than a decade of political interference, mismanagement, loan losses, and numerous brushes with insolvency. Many in the international community felt the Bank could never operate sustainably and should be closed. However, the Ag Bank's role in providing crucial financial services to Mongolia's vast rural areas meant that closing it would have had a catastrophic impact on the rural economy and the economy as a whole. Instead, an enlightened partnership between the Government of Mongolia (GoM), USAID and other donors recognized and leveraged the Bank's latent assets, namely its extensive rural branch network franchise and corresponding access to a large and underserved market. Ag Bank's subsequent rapid turnaround and successful privatization highlights the potential of commercially-oriented microfinance to transform even the most troubled state-owned banks into sustainable providers of financial services while also maintaining rural outreach.
- For 11,000 Malawians, opening a savings account at USAID-supported Opportunity International Bank of Malawi (OIBM), which began operations in 2003, is a new and important experience. This is particularly true for the 50 percent of them who had never before had a bank account. "By emphasizing savings, OIBM has taken a less common, sustainable path for microfinance institutions, most of which rely on donors to fund loans. Through OIBM a community's excess resources are collected and saved, and then cycled back into the

community in the form of loans, which when repaid are recycled into new loans. Outstanding deposits total $1.1 million. Through OIBM, entrepreneurs also have access to capital at fair market rates of interest—without producing collateral. In its first year, OIBM provided about 300 loans with an average amount equivalent to $300. About 70 percent of the loans went to women. Since 1971, Opportunity International has provided microcredit in developing nations at an average repayment rate of 98 percent. The impact of microfinance in Malawi helps whole communities, including the most vulnerable among them. With 15 percent of adults infected with HIV/AIDS in Malawi, the disease has taken a devastating toll on family life, including income. Families who can open a small savings account earn interest, which may help them to cover the cost of medications or a funeral. The launch and expansion of microenterprises results in job creation, as entrepreneurs become employers.

- USAID funding helped establish one of the first commercial microfinance operation in large, underserved markets of São Paulo, Brazil. Banco ABN AMRO REAL S.A. (ABN AMRO) partnered with ACCION International (ACCION) to create a microfinance subsidiary. ABN AMRO is the fourth largest bank in Brazil. ACCION is providing microfinance technical assistance to enable ABN AMRO to reach deeper into nascent microfinance markets. Since project inception in 2002, program is characterized by increasing financial sustainability and growth. From September 2002 to June 2004 the average total microfinance assets grew by nearly 22 times; and, from June 2004 to present, the average total microfinance assets grew by 350%. ABN AMRO's microfinance operations are on track to be financially sustainable before the project completion date in September 2006.
- USAID's supported the establishment of the first microfinance institution in Afghanistan—the First Microfinance Bank of Afghanistan—through a grant to the Aga Khan Fund for Economic Development. At project inception, Afghanistan did not have a functioning banking system. Those banks in operation were state-owned, and offered few financial products. A World Bank study stated that nearly 80% of entrepreneurs in Afghanistan highlighted the lack of financial services as a constraint to doing business. After its first few months of recruiting and training new staff, the First Microfinance Bank of Afghanistan opened its doors in August of 2004. The bank has already disbursed nearly $5 million (USD) to microentrepreneurs around Kabul and has collected over $13 million (USD) in deposits. The bank is also taking active steps toward increasing the number of women borrowers.

Improved laws, regulations, and policies for poor households and their enterprises: Benefits to poor entrepreneurs of the direct services described above will be greatly amplified if the policy environment rewards rather than punishes hard work and initiative, creates incentives for informal sector businesses to formalize, and levels the playing field between smaller and larger firms. In addition, improvements in the policy environment can greatly accelerate development of pro-poor financial and business services. In some cases, the Agency can accomplish more by helping implement a law than it can by supporting a single institution to deliver direct services. For example:

- In Ukraine, the average cost of business registration has decreased by 50 percent and the average time required to license a business has decreased by a similar amount. Because these costs weigh most heavily on the smallest firms, these successes provided the greatest benefit to small and micro enterprises. More important, greater transparency in the system has reduced corruption related to business registration by 84 percent. As a result, survival rates for new businesses in Ukraine increased by almost 20%. Over 378 regulations that constrained business development in the regions were changed. Consequently, 12 percent of the business training beneficiaries of BIZPRO, a regional USAID-funded enterprise development project, started new businesses; the survival rate of new enterprises increased by 18 percent, and 25 percent of training beneficiaries reported an increase in personal income.
- USAID advocated for the removal of interest rate ceilings and the termination of government directed-credit programs in countries as diverse as Haiti and the Philippines in the mid-1990s, unleashing an explosion of microcredit.
- USAID played a key role in Sri Lanka in the passage of the Intellectual Property Rights Law as part of a broader program increasing the competitiveness of Sri Lankan firms. The Intellectual Property Rights Law was a necessary to protect high quality Sri Lankan products from foreign knock-offs. While

these industries, composed of small, medium and large firms, collectively employed over 1,100,000 workers, their growth had stagnated. Businesses were unwilling to invest in improving the quality and reputation of their products due to a lack of intellectual property protection. The passage of the law removed this barrier.

- In Morocco, a USAID-developed business registration system helped improve the efficiency of the pilot Regional Investment Centers (RIC) in Agadir, reducing the time necessary to register a business from several weeks to less than one day; this system will be adopted by other RICs that have now been opened in 20 locations around the country. The commercial court of Agadir continues to report improvements in the time required to complete a case from 227 days in 2001, to 144 days in 2002, and 97 days in 2003.
- In Russia, laws drafted by a USAID-supported think tank dramatically reduced licensing, registration requirements, and state inspections that constrain the formation of new businesses. These laws, along with others on leasing, entrepreneurship and consumer credit cooperatives, were enacted with the help of the bilateral Small Businesses Working Group, also supported by USAID.

EXPANDING THE REACH OF MICROENTERPRISE DEVELOPMENT

Finally, we recognize that microfinance and microenterprise development are most effective as tools for poverty reduction among those who have the capacity and opportunity to be economically active. People who are particularly disadvantaged—by macroeconomic crises, conflict, or natural disaster, or equally by disease, a family death, a run of bad luck—may be in greater need of basic services such as health care, shelter and food. In some cases, microenterprise assistance may be relevant only if combined with other relief or development interventions.

As we continually evaluate the needs of our clients, the poor and very poor households and entrepreneurs, we must be sensitive to new challenges and obstacles that they face in their daily lives. In the case of especially disadvantaged populations such as victims of trafficking, natural disasters and HIV/AIDS, we have identified opportunities that will expand the reach of microenterprise development to aid these more vulnerable groups who may need more than finance and entrepreneurial assistance to seize and benefit from economic opportunities. We have found that in these situations, microenterprise assistance may need to be tailored to the specific local context and constraints of the target group.

Research in these new areas of assistance has been invaluable to better understanding the benefits and risks of various approaches and to effectively design programs that are attuned to the very real needs and opportunities of these groups. A brief overview and sample of our results in these areas is addressed below.

Anti-trafficking

USAID has funded anti-trafficking projects in South East Asia, including Vietnam, Laos and Cambodia, which incorporate support for livelihoods and microenterprise development. Approaches may include: linking skills training with income generation programs, microenterprise credit and savings projects, technical advice, group formation, and job service centers that support self-employment and business start-up as well as formal job-seeking. Targeting microenterprise development activities to at-risk women entrepreneurs in high trafficking areas will continue to be an important tool in USAID's approach to addressing the trafficking challenge.

HIV/AIDS

The HIV/AIDS pandemic is having a tremendous economic impact on households, businesses, and national economies. Micro and small enterprises (MSEs) are particularly at risk because they comprise more than 90 percent of all enterprises in the world and already face constraints to market access. The additional burden of HIV/AIDS on MSEs could be sufficient to push many of these firms out of the markets in which they are currently active. We have improved our assistance to these groups and developed promising approaches to reach them while also adapting support to all MSEs in HIV–AIDS-affected communities to ensure that broader programs do not exclude HIV/AIDS-affected entrepreneurs. A few examples are:

- In areas devastated by HIV/AIDS, such as in Zimbabwe, USAID missions are using microfinance to mitigate the economic impact on orphans and others affected by the disease. Currently, one in four people between the ages of 15 and 45 in Zimbabwe has HIV and some 624,000 children under the age of 15 have lost one or both parents to the disease. USAID funds programs to provide training, business skills, and financial services to affected commu-

nities. It supports microfinance institutions such as Zambuko Trust, a partner of Opportunity International, to adapt its products, cope with its own human resources disaster, and weather the crisis. USAID also assists the national microfinance network, Zimbabwe Association of Micro Finance Institutes (ZAMFI), as well as local affiliates of international networks. This support to national and multi-country networks has been a key component of the USAID mission's strategy for addressing the multiple needs of Zimbabwe's economically active poor in an integrated fashion.

- USAID is developing approaches to provide MSEs with better safety nets to help them avoid irreversible coping strategies (such as sale of assets or borrowing at exorbitant interest rates), and increase the likelihood that they will survive the impact of AIDS on the business. FINCA, Opportunity International, and other USAID partners have designed microinsurance products that enable HIV/AIDS-affected individuals to continue to access credit without placing undue risk on the family or the MFI. These products include credit life insurance, critical illness coverage, and funeral benefits insurance.
- USAID's program in Zimbabwe also identified labor shortages as one of the key constraining factors to participation in commercial activities by AIDS-affected households. In order to overcome this labor bottleneck, the program introduced drip irrigation to its home nutrition garden program. The drip irrigation system uses half of the water of conventional bucket watering, and so requires half of the labor for watering. By overcoming the important labor bottleneck, it allows AIDS-affected households to participate in an income-generating activity that may otherwise have been unattainable. This approach was subsequently taken to Ethiopia and adapted to AIDS-affected women in urban areas.
- USAID was able to increase the income of HIV/AIDS-affected households by supporting honey production and marketing. Honey is an ideal product for AIDS-affected households because of its overall low labor input and its relatively high return per labor input. At the time the project was started, honey production had a labor return of US$3.05 per hour, compared with US$0.44 per hour for a farm laborer on minimum wage. The Forestry Company, a private firm that produces, purchases, and processes honey, set up collection points to purchase honey from its regular suppliers. This allowed the firm to buy honey from producers in a given area without having to visit each producer to collect it. In order to ensure a consistent supply, the buyer also committed to providing the honey producers with training in hive management and bee-keeping, as well as information on the different grades that it purchases.

Tsunami and other disasters

To address the specific needs of tsunami victims, USAID has launched new programs to help get people back on their feet and back in business.

- For example, in Sri Lanka, thousands of livelihoods were shattered by the Tsunami—everything from destroyed fishing boats, to damaged guesthouses, to lost inventories. Before the tsunami many of the income generating activities were informal and part-time, but were crucial to meet household needs. Under the Revive and Upgrade Economic Livelihoods in Tsunami Impacted Areas (REVIVE), USAID is funding a $10 million special disaster assistance recovery fund through Office for Foreign Disaster Assistance (OFDA) financing. REVIVE finances activities through three windows: (1) cash for work to provide immediate liquidity to households, (2) assistance for the restoration of MFI operations thereby giving their clients access to financing, and lastly (3) economic opportunity interventions such as grants for productive assets, as well as training and skills enhancement for microentrepreneurs.
- In Banda Aceh, Indonesia, the Youth Branch of Muhammadiyah was able to recapitalize and restart their revolving loan fund. The only facility providing vital "seed money" for micro-entrepreneurs to get back to business, the fund now provides working capital for hundreds of microenterprises affected by tsunami. Approximately 80% of project funds have already been disbursed to micro-businesses involved with the sale of cooked food and drink, vegetables and fruit, children's toys, and clothing. Thirty percent of people receiving loans are women, and repayment stands at 100 per cent.
- More than 1,200 small entrepreneurs, farmers, and fishermen in Sri Lanka's Matara District will receive technical assistance, working capital, materials, and equipment. The program will also establish producer groups to encourage

sustainability. Group members will pool funds to purchase raw materials at discount rates.

Two aspects of USAID's work in the microenterprise development field particularly help explain its success. The first is a decentralized structure that relies on missions to assess needs on the ground, to design strategies and programs that respond to local realities, and to ensure that communities are directly involved in assistance provided to them. The second is diverse partnerships and a variety of instruments and mechanisms to maximize the range of expertise upon which the Agency can draw.

TAILORING ASSISTANCE TO LOCAL REALITIES

At all levels within the agency, USAID recognizes and embraces a tremendous responsibility to be responsive to local realities, constraints and opportunities and to design innovative, cost-effective programs that have best practices as their foundation while being tailored to client needs and the local context.

In microfinance, for example, the CGAP peer review points to USAID's decentralized programs and expertise as a strong comparative advantage vis-a-vis the 16 other donors. Long experience suggests that it is better practice for central units to play advisory and technical leadership roles than to program the lion's share of funds centrally or approve activities across the entire USAID portfolio.

DIVERSE PARTNERSHIPS FOR SUCCESS

A further advantage USAID enjoys is its ability to use diverse instruments and mechanisms, including grants for a wide variety of purposes, credit enhancement through the Development Credit Authority, and Global Development Alliance agreements to encourage private-sector engagement. The CGAP peer review noted that USAID has a comparative advantage in working directly with the private sector through appropriate instruments—and that there is widespread evidence that the private sector is more efficient at delivering financial services than governments.

In addition to the diverse instruments and mechanisms it employs to implement its microenterprise support, the Agency engages with a large number and broad range of partners, including international PVOs, local NGOs, business and trade associations, credit unions and cooperatives, consulting firms, governments, commercial banks, rural banks, finance companies, non-bank financial institutions and research or educational institutions, among others. Currently, the number of USAID partners in microenterprise development and microfinance numbers over 500. The diversity of partners reflects our comprehensive strategy of working to strengthen institutions, the financial sectors and markets in which they compete, and the policy environments that circumscribe their potential. Working at all of these levels demands a wide range of skills, and the Agency is committed to ensuring a level playing field that yields the best combination of partners to implement comprehensive programs efficiently and cost-effectively.

PROGRESS IN IMPLEMENTING PL 108–484

As reported previously, the Agency is undertaking a range of measures to comply with PL 108–484. We have established an office of Microenterprise Development (MD) and increased its budget, commensurate with its new responsibilities; its Fiscal Year 05 budget of $20 million is more than a third larger than its FY 03 budget level. We have initiated new programs, including central programs designed specifically to strengthen our relationship with our PVO partners and link them to mission programs.

Central Programs and Support to PVO Networks

Increased funding for MD has permitted the office to prepare a number of new competitive grant programs. The MD office will be conducting two rounds for the Implementation Grant Program in the coming year. "Access to Financial Services for the Very Poor," the RFA to be within the next two weeks, will focus on innovative approaches to increasing access to financial services for the very poor, that generate replicable processes, tools and methodologies for use by the global microfinance industry. "Linking Economic Growth to Poor Households," the RFA for which will be released by mid-October, will focus on approaches that foster the competitiveness of industries in which large numbers of small and very small firms participate; improve microentrepreneurs' access to the finance, business services, and knowledge they need to compete in growing markets; and ensure that the poor who operate these very small firms benefit from participating in growing markets.

The combined funding for these worldwide grant competitions will be $10 million. MD staff will carry out field-based appraisals of highly-ranked applications and make awards once funds are available in Spring 2006.

MD is also announcing several additional grant competitions, with funding of roughly $2 million, to support innovation and fund training and dissemination of best practices for microfinance and microenterprise networks, among other things. The first competition will be announced by the end of this month and awards will be made early in the coming fiscal year. MD was also able to provide additional funding to the Small Enterprise Education and Promotion (SEEP) Network for its competitive Practitioner Learning Program, which provides grants and technical assistance to PVOs and NGOs for innovative microfinance and enterprise development activities.

These new grant competitions respond to the provisions in the law concerning central programs and emphasis of eligible implementing partners.

USAID has designed the new microenterprise Leader with Associates (LWA) mechanism to achieve the policy goals reflected in the law, by enhancing USAID's access to the microfinance and microenterprise development expertise of the non-profit community and offering USAID missions a new and cost-effective option for carrying out work in this field. The activity, entitled Financial Integration, Economic Leveraging, Broad-Based Dissemination and Support Program, or FIELD-Support, establishes a mechanism by which a non-profit or consortium of partners can provide services directly to USAID Missions as well as other offices and operating units within USAID/Washington through Associate agreements.

The LWA Leader agreement (the base upon which future associate agreements will be made) will be awarded by the end of the current fiscal year. Its primary objectives include:

1. Strengthening the economic status and security of poor households;
2. Promoting economic growth that benefits poorer households and communities by supporting the access of micro and small enterprises (MSEs) to market opportunities;
3. Promoting the development of financial systems that are accessible to all and meet the diverse needs of MSEs and poor households; and
4. Improving the national, regional, or local enabling environment to boost the productivity, earnings, and competitiveness of MSEs.

The MD office will provide $10,000,000 for the base "leader" five-year agreement for activities which address these objectives. In addition, USAID Missions and USAID/W offices and operating units will be able to enter into "associate" cooperative agreements for an amount up to $340,000,000 over the five-year period. The LWA provides a contractually streamlined mechanism for missions to partner with NGOs and PVOs to meet poverty alleviation goals, as attractive an alternative to working with contracts and for-profit firms.

It is the agency's expectation that the LWA will facilitate stronger collaboration between microfinance networks, other microenterprise partners and missions. This 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.

This year's tranche of funding from MD will support initial activities worldwide that will focus on testing new approaches and sharing knowledge widely within the practitioner community about what is working. MD plans a proactive dissemination strategy to missions and other operating units once the LWA is in place, to promote rapid and large-scale take-up of this new instrument.

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Involvement of Microenterprise Development Office in Mission Microenterprise Strategies

The law requires the new Microenterprise Development office to concur in strategies of USAID missions and bureaus that include microenterprise and microfinance components. To date, this has primarily entailed MD staff preparing comments on new regional bureaus strategies that have been developed over the past six months to provide the overall framework and parameters for mission strategies. As missions begin to develop more detailed strategies, based on the guidance offered by their respective regional bureaus, MD staff will review the relevant portions, offer input as

appropriate, and decide whether to concur as part of the overall strategy review process. MD staff has been proactive in meeting the related provision in the law, i.e., that the Microenterprise Development office provide support and technical assistance for missions in developing new strategy elements and components. In the past year, for example, MD staff has provided on-site assistance to missions including Colombia, Mexico, Haiti, Brazil, Albania, the Central Asian Republics, Azerbaijan, Serbia, Morocco, Egypt, Jordan, India, Sri Lanka, Sudan, Uganda, Tanzania, and South Africa. Staff has also provided extensive virtual technical support in both strategy and activity design for diverse missions including Pakistan, Iraq, Indonesia, and Afghanistan.

Choice of Implementing Partners

Achieving the best combination of partners is key to the Agency's microenterprise program, which draws on the talent and experience of some five hundred diverse implementing partners. Many but not all are nonprofits. We design our assistance agreements and programs to make the best possible use of the capabilities and expertise of this diverse practitioner community so that we can work effectively at all the levels of intervention required for success—from direct service provision to laws and policies..

The great majority of direct service providers supported by USAID are private, local organizations, including NGOs, cooperatives, credit unions, banks, non-bank financial institutions, business service providers, exporters and other marketing companies, training organizations, technology firms, consulting firms, and business associations. Sometimes USAID provides them with direct grant or DCA support—in other cases, USAID can more cost-effectively reach these direct service providers through intermediaries such as parent NGOs or PVOs that support them or organizations contracted by USAID to build capacity of multiple service providers at one time.

Typically, our international nonprofit partners—such as the leading microfinance networks and other US PVOs—function as intermediaries for technical and financial support to local service providers, rather than functioning as service providers themselves. Over the years they have demonstrated particular capacities to develop responsive, sustainable local organizations that deliver both financial and business services to poorer entrepreneurs and families. In many instances they have demonstrated their ability to build strong local institutions that serve as initial market leaders and can often grow dramatically to respond to increased client demand for services. The development mission of non-profit NGO and PVO intermediaries has often motivated them to seek innovations to serve poorer clients, reach more remote communities, or combine microenterprise and microfinance assistance with other critical interventions such as health care and education. In addition to their strengths as capacity-builders, the nonprofit structure of these partners permits them to mobilize private-sector resources from private donors and investors to support their local affiliates.

Some important microfinance and microenterprise development strategies require specialized expertise and scope of capacities not typically found in nonprofit PVOs. For example, policy work and building the capacity of regulators and supervisors typically draw more on the expertise of for-profit consulting firms, think tanks, and other specialized entities. Some consulting firms have developed the capacity to carry out complex retail capacity-building activities, such as the restructuring of very large state-owned banks. While PVOs may engage in some types of applied and action research, educational institutions and consulting firms are often better at other types.

Obviously, it is difficult to generalize with absolute precision about the comparative advantage of different types of USAID implementing partners to implement different types of activities. However, these characterizations reflect our experience of almost three decades and shape our efforts to match the job to the expertise, capacity, and business model of the implementing partner.

Increasingly, missions are implementing microenterprise and microfinance activities through larger "umbrella programs," where a single awardee (which can be 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 single entity, typically the umbrella program is carried out by a consortium of partners with distinct expertise, given the breadth of skills required by the program. As noted below, often a substantial share of the overall funding for the program is set aside for subgrants and subcontracts to local service providers. Sometimes these umbrella programs are managed by apex organizations created specifically to channel technical and financial support to direct service providers.

Umbrella programs offer a number of advantages to USAID missions. Most importantly, they offer a cost-effective way to ensure that all the ingredients required for success—capacity-building and operating support for direct service providers, support for value chain development, strengthening support services for microfinance such as auditing firms or training services, policy analysis and reform, training bank supervisors to oversee microfinance operations—are brought together and can respond to changing circumstances in a comprehensive and flexible way. This is particularly important to the many USAID missions that are being asked to program larger budgets without concomitant increases in technical staff and procurement officers. They are attractive to missions precisely because they allow missions to advance complex programs with diverse partners doing what each of them does best, without incurring undue management burden. Another important advantage of umbrella programs is particularly obvious in more mature, competitive markets, where USAID and other donors fear distorting the market by providing too much support for a small number of individual service providers; umbrella programs offer a means to provide more target, "lighter" technical and financial assistance to a larger number of diverse service providers. In contrast, the leading PVO microfinance networks typically work with a single partner in any one country and would find it inappropriate to support multiple players. Use of an umbrella design can—and often does—involve creation of a substantial program component to make subgrants to direct service providers, an activity that may be beyond the contracting capacity of the mission to do directly.

As we have reported previously, USAID currently has underway a qualitative study that is analyzing experience with umbrella programs. It will serve as the basis for more detailed policy guidance to missions on whether, when and how to carry out microfinance or microenterprise programs through an umbrella design. This will include guidance on such controversial issues as tailoring the design of activities to the stage of market development, alternatives for supporting market leader institutions, achieving an appropriate balance of resources between retail-level and policy-level work, ensuring effective oversight and approval of subgrant programs, and creating adequate incentives for optimal use of local consultants and sources of technical assistance (to achieve both cost-saving and capacity-building goals).

Because umbrella programs managed by for-profits typically involve sub-obligations to non-profits, accurate data on the full amount of USAID microenterprise funding to non-profits has remained elusive. However, we have instituted changes to our Microenterprise Results Reporting system in order that, beginning with the June 2006 report to Congress specified in this law, we will be able to report on the full amount of funds for non-profits including PVOs, NGOs, credit unions and cooperatives.

As it is, the MRR system captures data only on the share of USAID funding received *directly* by US PVOs, NGOs, cooperatives and credit unions for services to poor entrepreneurs. This share has averaged around 46% in the 1997–2004 period (the figure was 51 percent for FY2001, 45% for FY2002, 42% for FY2003 and 45% for 2004). As noted above, these nonprofit partners actually receive substantial additional funding through subgrants made by umbrella programs to direct service providers. In addition, PVOs and NGOs sometimes receive subcontracts to provide technical support to their local affiliates or carry out other technical work. Thus, even though we will not have the precise allocation until next year, we can state with some confidence that nonprofit implementing partners receive over half of USAID microenterprise funding.

Development of Tools to Assess Client Poverty Status

The Microenterprise for Self-Reliance Act mandated that half of all USAID microenterprise funds benefit the very poor. This legislation was amended in 2003, and now defines the very poor as those living on less than $1 a day, or those living in the bottom 50% below their country's poverty line. The lack of widely applicable, low-cost tools for poverty assessment makes it difficult for USAID to determine whether it is meeting these mandated targets. Therefore, the law also requires USAID to develop and certify at least two tools for assessing the poverty level of its microenterprise beneficiaries.

An ambitious work plan is underway to have the poverty assessment tools designed, field-tested and ready for implementation by USAID in October 2006. Tools have been tested for accuracy and certified on a preliminary basis, pending tests for practicality, which will be conducted by practitioners who have received grants to do so. Last week, those practitioner grantees came to Washington for training, and they will begin testing the tools in their countries beginning as early as next month. The final tools, adjusted as necessary following the practicality tests, will be imple-

mented by all partners that receive USAID microenterprise funds beginning in October, 2006. We hope that the tools will prove sufficiently valuable and cost-effective to more accurately measure the poverty status of clients of USAID-supported microenterprise institutions. We also hope that, once questions about poverty measurement have been addressed, the Agency and its partners can turn our attention to questions about how better to serve very poor clients.

Data Collection and Analysis

For more than a decade, USAID has used its well-regarded Microenterprise Results Reporting (MRR) system as a means to ensure accountability for microenterprise funding and for the results of microenterprise programs supported by USAID. The top marks USAID received in the "accountability" category of the CGAP peer view are due in large part to the comprehensiveness and quality of the data and analysis generated by MRR.

MD has been working with the MRR team to respond to the many additional reporting requirements and data needs resulting from the new law. MRR already has added a module to allow us to capture data on sub-obligations, such as subcontracts and subgrants that are often a central component of microenterprise umbrella programs, to help us analyze issues such as the relative share of overall USAID funding devoted to contracts, grants and cooperative agreements, the extent of funding for direct service providers, and other efficiency and cost-effectiveness considerations raised by the law. MD is also working with MRR to put in place the basis for the required monitoring systems USAID for its microenterprise work, which will offer a base from which to recommend changes to enhance performance.

The additional reporting requirements in the new law are leading to other enhancements to MRR as well, to enable us to analyze and report on:

- the comparative cost-effectiveness and sustainability of projects carried out under these various mechanisms.
- efforts regarding "trafficking of persons and women who are victims of or susceptible to other forms of exploitation and violence";
- an estimate of the percentage of beneficiaries of assistance under this title in countries where a strong relationship between poverty and race or ethnicity has been demonstrated; and
- the estimated percentage of assistance allocated to the very poor and the estimated number of the very poor reached with assistance.

These analyses and reporting systems will permit us to comment in more depth, in the June 2006 report to Congress, on the nature and amount of support to specially disadvantaged populations. They will also form the basis for reporting on the comparative advantages of different kinds of implementing partners and other program design and implementation issues related to the policy goals of cost-effectiveness, efficiency, and sustainability that are of critical importance to USAID and have been underscored in the microenterprise law.

CONSULTATIONS WITH IMPLEMENTING PARTNERS

Earlier this year MD staff convened a very well-attended consultation with the PVO community of microenterprise practitioners to outline its new grant initiatives and seek input on priority issue areas. Throughout the year MD worked very closely with the PVO community on design of the new Leader with Associates mechanism, including: seeking practitioner input in multiple venues; issuing a draft Request for Applications to permit extensive comment on its priorities, design, and selection criteria; and hosting a conference for prospective applicants that attracted more than 60 participants. MD also has continued discussions with the practitioner community about ongoing areas of collaboration such as the Business Development Services grantee network and SEEP's Poverty Outreach Working Group and other working groups. The practitioner members of the poverty tools advisory group have participated very actively throughout the year and provided the essential "users' perspective" on both the accuracy and practicality aspects of the tools development process. USAID is planning a major Microenterprise Learning Conference in January of 2006, and is seeking active practitioner involvement in planning the agenda and sessions.

In sum, USAID has moved vigorously to implement the new microenterprise law and made much progress on each of its key provisions. We are committed to continuing to do so, in close consultation with Congress and our implementing partners. I am happy to answer additional questions you have about the Agency's implementation of PL 108–484.

Mr. SMITH OF NEW JERSEY. Thank you very much, Mr. Smith, for your testimony, and let me just ask a few opening questions. But before I do, for any opening remarks, I would like to ask Ms. McCollum if she would like to address the Committee.

Ms. MCCOLLUM. Well, thank you, Mr. Chair. I think this is a very timely hearing to be having as we are discussing how to lift the poorest of poor out of poverty and also create ladders for people who are poor to become more self-sufficient. But we have to keep in mind that when we are talking about the very poor we are also talking about people who are facing food insecurity, a health crisis, lack of access to clean water, fuel for cooking, children not in school, limited resources for farm input, seed and fertilizer, just those basic things that they need to have; as well as, from my trips, many of these are the people who have the fewest skills available to them as far as education.

They also have, because of their location quite often, institutional barriers, lack of access to a banking system to keep fundings and funds safely, and lack of transportation. So we need to address this, but we also have to make sure that we set up programs that are going to allow people to succeed, and we need to then make sure, for other people, what we need to do to put them in a situation to take advantage of programs like microfinancing and microcredit.

Mr. Chairman, thank you so much for having this hearing. I am very excited to hear from the testifiers and work with you on this very important issue.

Mr. SMITH OF NEW JERSEY. Thank you very much, Ms. McCollum.

I would like to recognize the Ranking Member, Mr. Payne.

Mr. PAYNE. Thank you very much, and let me also express my appreciation for having this very timely meeting on the Microenterprise Results and Accountability Act. Thank you for calling this meeting, and I have certainly enjoyed working with you over the years in strengthening our microenterprise programs abroad and working to ensure that at least 50 percent of the funding reaches the poorest of the poor. I think that is very important, because that is why microenterprise programs are so important, the truly poor can do so much. And not to sound gender specific, but women tend to do an outstanding job with so little in developing countries. This is specifically what Chairman Smith and I have been working toward over the last few years, and that is why this hearing is so important.

I am pleased that we are holding this hearing on the implementations of the Microenterprise Results and Accountability Act of 2004, which was an effort by this Committee to increase USAID's effectiveness in its microenterprise work. This act was a great effort on our part to ensure that the world's very poor are reached with the antipoverty tool. With the Millennium Development Goals due in a decade, we do not have a moment to waste. As a matter of fact, since the goals were declared in 2000, we have not seen enough progress in these 5 years, and so we have to double our effort to speed up the pace.

My colleagues and I, particularly Chairman Smith, have long been supporters of microenterprise and believe it to be a very effec-

tive tool in underutilizing poverty alleviation tools. It is amongst the best because it gets right down to the grassroots.

In the early and mid-1990s, our U.S. Department for International Development was the world leader in this arena, and I think it is important, and the importance of this work, that USAID should continue to move in this direction and the importance could not be overstated at all. However, in recent years I have been concerned about the trend of directing increasing amounts of precious microenterprise resources to contractors and for-profit organizations while the funding for cost efficient, highly effective NGOs and PVOs have dropped. That is a trend going in the wrong direction, in my opinion. The result of such funding trends is that while we here in Congress have been increasing our authorizations and appropriations for microenterprise funding to $200 million in fiscal year 2005, significantly more money is being taken off the top for highly paid contractors before it can ever reach the people on the ground.

I hope that today we will hear good news about progress toward the development and certification of poverty measurement tools as mandated in the 2004 act so that we can actually monitor where our microenterprise funding is going and whether 50 percent of it is reaching the very poor, as is currently in the law and is a congressional priority. That is for sure.

The focus should be innovation in products and services for those who are very poor and difficult to reach with measurements as a means to that end so we can see how effective or ineffective our programs are.

I would like to point out that much has been done by USAID that should be noted and encouraged. When they don't do the job well, we let them know. But when they do something right, I think they should also know it. In fact, I believe that this should be a model for all donor agencies, bilateral and multilateral, who are truly serious about reaching the very poor and reaching the Millennium Development Goals.

I also hope to hear about USAID's future plans to expand its work for the very poor in Africa. Although several of the world's regions have made significant progress in achieving the U.N. Millennium Development Goals, sub-Saharan Africa remains the exception, appearing to move backwards rather than forwards. A U.N. progress report made earlier this year showed that although the proportion of extremely poor people fell to 21 percent in the developing world, in sub-Saharan Africa, which already had the highest poverty rates in the world, millions more fell into deep poverty, and we see once again the trend going in the wrong direction. Current statistics demonstrate that, despite the fact that while 61.5 million of the poorest families in the world live in Africa, only 7.8 percent of those families were reported as reached with the microenterprise at the end of 2003. Comparing this to the 31 percent coverage in Asia, and I know we have these challenges, I think that we are here to try to examine it and see how we can make this very important program more successful.

So, once again, Mr. Chairman, I thank you for calling this important hearing and look forward to the testimony of our witnesses.

Mr. SMITH OF NEW JERSEY. Mr. Payne, thank you so much, and thank you for your good work on this as well.

Mr. PAYNE. Thank you.

Mr. SMITH OF NEW JERSEY. Let me just begin the questioning, Mr. Smith. As you know, the USAID strategy for building microfinance in the 1990s was to invest in market leaders, often by providing core support to microfinance networks that then went on to build strong retail microfinance institutions. This strategy was obviously successful, and the leading global microfinance networks with USAID assistance developed a strong track record in creating a thriving microfinance industry in many countries. Yet funding for the central Office of Microenterprise Development, or OMD, at USAID has been reduced in recent years. The very effective PVC matching grant fund program is now defunct and USAID is increasingly providing assistance through for-profit contractors. And you know that was part of the genesis of the bill. The result is that these global microfinance networks have found their USAID funding has diminished dramatically in 2004 and 2005, just at the point where they are prepared to ramp up for significant growth.

And my question, as you probably know, among the top 125 microfinance organizations in the world, all but a handful were launched with the support of NGO practitioner networks. This means that in most countries most of the clients receiving services have NGO practitioner networks to thank.

How could USAID partner with NGO networks to continue making this kind of contribution in the development of microfinance?

And, secondly, as you know, Section 252(B)(2)(a) of 108–484 states that the Agency shall, and I quote it, and you know it, I am sure, "emphasize the use of implementing partner organizations which are defined as not-for-profit entities." In what way has the Agency emphasized the use of these agencies in 2005, and in what ways will you seek to achieve it in 2006?

Mr. SMITH. Thank you, Mr. Chairman. This is an excellent opportunity to discuss these issues. I think we should look perhaps first at funding, funding levels, and I believe that there is a color chart available to you. Indeed, there has been quite a growth in the amount of funds. This reads from 2001, on the right, to 2004, on the left, and there has been quite an increase, as you have noted, in the funds going to primary recipients being the consulting firms as it is identified on the chart.

A lot of these arrangements are umbrella arrangements. And to illustrate how funds flow, we have provided an example from El Salvador of an umbrella arrangement in which the—if you will look at the pie chart below—the consulting firm used the majority of the funds but did subobligations to credit co-ops and to NGOs in the red and yellow portions of the pie chart.

In the microenterprise results reporting tool we do not have information readily available for past years on subobligations. In the early years that was not a major part of how we did our business. Now that it has become a more significant part of doing our business, we have revised the reporting system so that we will be able to track the flow of funds through primary umbrella contract holders to all of the subentities. So the data that you see, I think, clearly shows that there has been a maintenance of the absolute levels

going to the PVOs and NGOs, and so forth, but there has been an increase going to contractors. But that increase overstates the actual increase since a lot of those umbrella agreements are intended to flow funds through to the very partners you were talking about.

So we need to get much better data to you, and we will on our next report about the funding levels and how they are evolving. But I think we also need to discuss why we have entered into umbrella agreements. I think that is important for this Subcommittee to understand.

One very important substantive reason is the desire to have integrated programs that really go from the policy level to the retail level and back because we recognize the important contribution that our partners have made at the retail level. We have come increasingly to understand the importance of policy issues to the success of that retail level. And if you will allow me to tell a story.

I had the very fortunate opportunity at the invitation of Lawrence Yanovitch to join him on a field trip in Ecuador to look at FINCA Ecuador's model operations there. But we also had a chance at the mission to speak with the superintendent of banks, and that reinforced policy work that had started a number of years ago through WOCCU with the superintendent which we continued through DAI, it turns out in this case. The consulting firm brought in expertise from around South America which was best suited to advising the Ecuadorians as to how to revise the regulatory frameworks to expand microfinance, and they have done so. The market for microfinance now in Ecuador was, in July, $480 million total portfolio. FINCA Ecuador, which has a model operation, was at about $13 million, one of the players in that market now.

The mission is looking for ways through the umbrellas, therefore, of supporting a lot of the new entrants into the microfinance industry, along with all of our traditional partners. So we have a very rapidly expanding microfinance industry. I think Professor Morduch talks about probably reaching 100 million clients around the world by this time based on the trends that were going on through 1997 to 2002. So with this rapid expansion of the industry, we are seeking to improve industry standards and really reach a lot of new entrants into the field as well.

So we are really diversifying how we are putting our funds out and who we are working with, and we need to take advantage of our traditional partners' expertise that started many decades ago and has been developed over the years. But they are not the only players, is my point.

Also, to continue with Ecuador for just a minute, one of the features that we are going to have in that program, and that was part of the trip that Lawrence invited me on, was publicizing a bond issue. Now, the bond issue to raise capital in the Ecuadorian financial markets will raise about $5 million for FINCA Ecuador. To help that bond issue achieve the best possible rates, we are guaranteeing 50 percent of the value of the bond issue through the development credit authority that Congress is giving us. So we are looking at innovative ways to try to increase access of the partners to capital markets. They are already very close to sustainability there anyway. This is an excellent way to continue to expand the client

base, in our view, and is more effective than providing direct subsidies for capital, which is the way we all started.

So that is the basic story about why we are entering, one of the reasons why we are entering into umbrella arrangements, to get that whole policy down to retail and back up.

Another important issue that I really want this Subcommittee to understand well is that it is partly also driven by staffing constraints in the Agency. The move to Eastern Europe and the transition states, the downsizing in the 1990s that took place and where we are now in the 2000s means that we have missions that are about 40 percent smaller in all of these regions than we had by the early 1990s, mid-1990s. With fewer technical staff and fewer contracting officers available to serve all of the mission needs, we are looking for more efficient vehicles to put money through.

I think the Administrator has probably talked before about the operating expense constraints on the Agency and how it affects the way we do business, and I think this is one area in which that binding constraint is felt by the types of responses we have developed to deal with that staffing constraint, but I think we have done so very effectively. We would like your help otherwise.

Mr. SMITH OF NEW JERSEY. How many staffers have you lost, say, over the last 5 years?

Mr. SMITH. How many?

Mr. SMITH OF NEW JERSEY. Staffers, so you don't have that technical capability in the field.

Mr. SMITH. We are currently in over 80 missions around the world. In the mid-1990s, we were at about—I know the African numbers because I was head of that office for a while. We had about 340 officers in the field. Now we are down to below 200 officers in the field, American direct hires. So we rely more and more on local employees, professional employees that we hire locally to carry out work. We have less American oversight in the missions where we still have missions. And so part of the adaptation to carry out the multiple mandates that Congress gives us is to try to develop vehicles that group work together and do single procurements rather than a dozen procurements, and that affects the entire business model.

Mr. SMITH OF NEW JERSEY. Is the lack of staff in Africa, for example, why in 2002 there were only about 20 percent of the funds going to Africa? Was it a loss of staff and the ability and the capacity to run the program, or was it just by design that Africa got 20 percent?

Mr. SMITH. I looked very carefully at where the microfinance and microenterprise development funds were going across the Agency over the past 6 years. It fluctuates from year to year, but you can almost bet that 25 percent goes to each of the four major regions. The average over those 6 years was 25 percent. So that if 1 year it is dropping to 20, it is just a fluctuation in programming; it is up to 30 the next, and it averaged to 25 across the 6 years for Asian Near East, Africa, African America, Europe, and Eurasia. So it is a——

Mr. SMITH OF NEW JERSEY. How much more additional resources would you need to expand significantly the job that you are already doing?

Mr. SMITH. Additionally?

Mr. SMITH OF NEW JERSEY. Yes. How much more money, how many more staffers?

Mr. SMITH. We are—let me see. I can't talk about all the internal discussions, our dream of course is our blue sky, but I can't discuss those. But with the primary areas in which we need additional staffing are the ones I mentioned in technical and in contracting. We would definitely like to build up to the kind of field presence that we had over a decade ago. That would help us expand programs. We don't have a formal request to Congress——

Mr. SMITH OF NEW JERSEY. Could you provide the Subcommittee—and I know the dark skies of OMB needs to be—I mean, I am asking you a direct question. If you could provide the Subcommittee with what a plan would look like to increase our capabilities, because we very often—and I know your budget goes through a process where it is shredded—and that goes for every agency. But we would really like to know what some of the plans are so that we can react to them in a way that helps more people. If you could provide that to the Subcommittee in direct response to a question, we would appreciate that.

Mr. SMITH. I think we can provide some very useful examples for you to see.

Mr. SMITH OF NEW JERSEY. I know when we get to those who want to cut the budget on the Floor of the House, very often they cut personnel, thinking that they are not cutting other outcomes. And I think your point about not having those people on the ground in missions is a very good one, requiring other more seemingly creative ways of getting the money out to those people.

Let me ask you on trafficking, if I could. As you know, Public Law 108–484 states very clearly that the Agency partner should assist victims of trafficking and women who are victims of or susceptible to other forms of exploitation and violence, and I am wondering in what ways the Agency has communicated this directive to the missions. I would note, parenthetically, I recently went to a shelter in Ethiopia where trafficked women—these are the lucky ones—were actually getting help, assistance, psychological and emotional help, as well. They are also teaching the ladies there how to make these shoes, and all of them are learning a very marketable skill and the shoes are very well made. And I bought them while I was there. But when they go back to their homes throughout Ethiopia, they are going to need startup capital to get that going, and I am just wondering what is being done. These are people who are, in the greatest sense of that word, survivors and overcomers. In talking to them—and they spent about 2 hours at their shelter—the stories they told were horrific, but to see the resiliency of their souls and their hearts and the desire to get into something where they can really make some money for themselves and their family was inspiring.

So what about that for that very special group of people?

Mr. SMITH. Yes. As you said, we have funded anti-trafficking projects in Southeast Asia with microenterprise elements that have been very beneficial. For example, in Vietnam, a transit facility has been established to assist returning Vietnamese women and provide reintegration assistance which includes microfinance and

skills training. I think in your opening remarks you noted that people need immediate assistance that can't be in the form of indebtedness, but then they need to have something to help them get going, provided they have the skills and the ability to conduct business.

The other interesting point is that the literature is very clear that women are the best clients of microfinance, and they dominate the microfinance climate base. They repay more reliably than men and are more successful generally than men. And when they receive microfinance loans, the impact on their households is greater than when men receive those same levels of microfinance lending. I think Professor Morduch would probably speak to that point as well in his panel.

So, yes, we are definitely looking for opportunities to make microenterprise development activities available to women entrepreneurs at risk from or exploited by trafficking.

Mr. SMITH OF NEW JERSEY. As I think you know, in 2003 I sponsored H.R. 192, which asked for the development and implementation of better poverty assessment tools. I wonder how that is coming along, if you could tell us.

Mr. SMITH. We have been working through IRIS at the University of Maryland to develop six different tools. We have certified two of them as accurate, and by that we mean that the tools developed data about the absolute level of poverty. That is very highly correlated with the more expensive Living Standards Measurement System (LSMS) methodology of the World Bank.

The reason that is important is that we want these tools to not be burdensome. We are finding that probably 15 to 25 questions will suffice to generate sufficiently accurate data about poverty through those tools. Now, two of them we know are accurate. We are still testing the others, the other four, and we will be testing all six for practicality. When you do this type of work, whether it is at the client intake level, which we think is probably not the best way to do it, or through household surveys or spot surveys, you have really got to test those questionnaire tools to see if you are getting the responses from the clients that allow you to measure accurately. So we are getting there and we will have them in place in October 2006 as required by law. We are quite happy with the progress we are making with IRIS.

A number of practitioners asked why they couldn't just use the tools they currently have, and our examination of their existing tools are that they are quite good at measuring relative poverty; we don't think they are as good as the tools that we are developing that draw inspiration from their tools and other sources, and so we are working hard to get all that working well.

Mr. SMITH OF NEW JERSEY. Thank you, Mr. Smith.

Ranking Member Payne.

Mr. PAYNE. Thank very much.

In your response about the funding, you indicate that the funding is done in four regions. And we have noticed that Africa was less funded. So, therefore, you can then prognosticate that, in the outfunding in the year or two that that will come up to the four equal funding regions as you mentioned.

Mr. SMITH. They have been equal historically across on an average basis. I believe—well, I don't see any clear trends among the regions, but there are very clear differences in poverty in the regions.

The constraint that missions face in programming is the overall development assistance budget constraint and the need to do both trade capacity building work and microenterprise work in the economic growth section of funding primarily, although there is also, from other accounts, microenterprise funding that comes forward. So it is really a mission by mission response to the conditions in the country and development of programs that are responsive to reducing poverty. I hope that helps a bit.

Mr. PAYNE. It is just that it seems that if there—unless it is in capacity. If there, if you have more abject poverty in a region to fund all—and I am sure you don't, like you say, you don't have blue skies. But to fund each area at the same level when you might have a region that has much higher level of abject poverty seems like it is robbing from Peter to pay Paul, but if it is so glaring that abject poverty happens to be in one region that it may even be fair to maybe not bundle all four regions equally; in other words, that where the need might be greatest, that might be where you would put a little more emphasis.

Just on the—I am sure you will agree with that and so I didn't really need an answer. But also we spent time in Ethiopia; it seems at least once a year I get there. And we did visit a very impressive USAID program. And these were HIV survivors, and it was a sort of a weaving program where very beautiful garments were being handwoven on the old kind of looms. And I wonder whether—and they seem really very attractive. Not me so much but Noelle, I guess, bought everything they had there. There was no shopping on the tour in those couple of weeks we were in Africa, so I think she did it all in that one visit in a half hour and about cleaned the place out. However, the materials were very impressive. The work was really well done, very tedious.

Is there any mechanism as part of your program to merchandise those? It seems to me that as many of those garments—there were shawls and things of that nature. It seems like there would really be a market for that. And I just wonder whether those things are encouraged, and if there is a marketing component for—I am talking about bringing it here into the U.S., you know, that kind of thing.

Mr. SMITH. There is the whole business development side of the Microenterprise Development Program where we advise companies on, such as the group of women, on how if they have issues with production techniques that might be improved, cost control issues, marketing issues, and so forth. So, yes, those kinds of programs do exist where we can help the microenterprises better exploit the market that they face.

Obviously, as an agency, we are not in a business for merchandising ourselves, but we are looking for market forces to work better and to help them use the market forces effectively.

Mr. PAYNE. Finally, there is an occupation that women have which is extremely very difficult. I don't know if you have been in Ethiopia much, but they have women who carry big bundles of

wood. And they go up to where the wood is—it is further and further out and further away from the urban center. And sometimes it takes the typical woman, it takes about 6 hours to get to where the wood is and then have to gather it and put these great big bundles on, and it takes another 6 hours to get down back to town. And then they have to sell it, and the total amount is $1 that this person earns for this, I mean, this 14-hour day. And they do it every day, and they will bring in younger children to also carry the load. The USAID had an HIV and AIDS program where they would just on the side of a hill have a place for them to stop for a few minutes and give them a little coffee, but to talk about family planning, HIV and AIDS, and things of that nature. But just to see these hundreds and hundreds and hundreds of women come down the mountainside with these big bundles. And like I said, they get $1 for the bundle, they even have to sell it. So if there could be some ways to expand more, you know, humane programs that could possibly pull some of those—I mean, they will figure another way to get—I am sure they could get a little truck if they really wanted to do something, and these women really don't have to be almost beasts of burden. And that is basically what they are.

Thank you. Thank you, Mr. Chairman.

Mr. SMITH OF NEW JERSEY. Thank you.

Mr. Tancredo.

Mr. TANCREDO. Thank you, Mr. Chairman.

And I apologize, Mr. Smith, for not being here at the beginning of your testimony. And so my question, I think, will be directed toward eliciting a response that perhaps—and I could understand if you would suggest that you don't have data on this. But, I mean, the purpose certainly of the program, of the microloan program is to improve the quality of life for the people who are the recipients and the participants, and I certainly agree with that as a goal. I just wondered if you could tell me, do you have any indication as to what are the observations of the people who are benefited by it in terms of the United States of America? How do they think about us? Do they actually know that, you know, and understand the source of this and purpose of it? And I don't want to sound like that is the whole reason we do it, but on the other hand I just wonder if they know.

Mr. SMITH. That is a very interesting question, and it is an important one, I think. That is why I have this pin on that says USAID and why we try to make our presence known in the rest of the world, because it is true that a lot of people don't understand what it is we are supporting. And Lawrence and I on our trips, on the trip we shared into the interior of Ecuador, a little bit up the Andes, I asked that question: Do you know who USAID is? And well, that is at least the organization that was behind some of the support, not for that particular program in this instance actually. And people did not know. They knew who FINCA was, and that is already a good thing, but they didn't necessarily identify FINCA with the United States, although Lawrence may want to comment on whether that is true or not. But it is often the case that our implementing partners are well known but the U.S. Government being behind them and supporting them is not well known.

So we have had this branding campaign and are trying to make sure that the contributions of the American people around the world are understood by people. It is a challenge.

Mr. TANCREDO. When you say a branding campaign, you mean wearing the pin?

Mr. SMITH. Well, I wear a pin. We make sure that the identification of the United States is on project materials that we are supporting there, branding in the sense of a corporation branding getting its brand out to the public, so that it is known that the U.S. Government is playing a positive role in their lives.

Mr. TANCREDO. I just don't think that it is too much to ask that that happen and hope therefore that goodwill develops in places that perhaps it wouldn't otherwise, and I think we all benefit as a result of that. I don't want it to appear to them as that we are giving this and therefore I want you to like us. I just don't understand why it couldn't be part of the agenda.

Mr. SMITH. It is part of the agenda. It hasn't always been a part of the agenda, but it definitely is now. The Administrator repeats the story of the reaction of the Indonesians to the response to the tsunami and the assistance that was clearly identified with the United States and how that changed public opinion about our country in Indonesia, which is heavily Muslim. So we need to repeat that kind of effect in our programs.

Mr. TANCREDO. I sincerely agree. Thank you, sir. Thank you, Mr. Chairman.

Mr. SMITH OF NEW JERSEY. Thank you very much. Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chair.

I am going to kind of maybe build a slightly different question than what has been before. In my opening statement I spoke about the very poor people who might lack skills, or even the time because of having to look for water, not having agricultural crops come in very well because of lack of fertilizer and to even dream of taking that next step. But there are two instances in which sometimes communities can kind of come together and be supportive of one another to take that step, so it is a community taking the step. Not necessarily that the community gets the loan; the individual gets the loan. But there is a support network built into it. And we have with what is going on with the youth, particularly with AIDS orphans in Africa, an opportunity, I think, in front of us where we have a lot of students who have had the ability to have some secondary education or at least have more education perhaps than maybe their parents had. But there is lack of any inheritance, quite often, land or anything for them to have as trade or for barter to start up doing something for business. And in meeting with some of the older vulnerable children, some of the questions I had of one young man who has been doing very well selling some of his woodworking, and at the Catholic mission I was at, he was like, "Well, you know, how do we take this the next step? Because I placed really well at this art competition that they had, and when I sell this I can do well." But he would need a mentor or somebody to help with them. There were some other orphans there that also kind of spoke up of ideas or things that they wanted to do. One had been taking some tailoring classes and trying to figure

out some way to get a machine put together, and two of them were actually in fact talking about how could they purchase a machine. So I sent those remarks on to our USAID Director, Pam White, who I spent a week with, who is fabulous.

So my question is, are we thinking kind of out of the box? Or is that another thing where you are bumping into not being able to do that because of staff? You know, think of new ways to do it, put up an idea, be willing to let us allow you to take a risk to try something to figure out how it works.

The other thing that I went to, and I will plug my own district, it was a Land O'Lakes co-op, where women come together and kind of—yes, they each have their own cow, but they come together for doing the marketing and the things that Mr. Payne was talking about. How are we coming along on things like that? Or is this an issue where you need more staff in order—I mean, we can dream all kinds of things, too, and say take it out of hide. That means something else suffers or that we don't allow it to ever become successful. What is your reaction to those two items?

Mr. SMITH. Well, one reaction is that those kinds of activities are best done by our partners rather than by the Agency itself. So it is not immediately a question of staff, it is a matter of experimentation by partners through whatever instruments we are using so that a lot of those ideas can be tried.

My other observation in general about the burdens of poverty that sort of are weighing on all these folks is the need for much better policy environments. Let me tell you a short story, if you will bear with me, of a group of women I met in Honduras who spent—who were all processors of foods sold in the local market. They did a lot of interesting things; fruit wines and preserves and so on. They were quite good at what they did. But in Honduras there is a growing use of supermarkets throughout the economy. The middle class uses supermarkets and so on. Throughout Central America there is a big growth of supermarkets.

This group of ladies decided to become registered as a business. Well, can you guess how long it took them to become registered as a business? Eight months into attempting to become registered and going through the bureaucracy of doing that, they turn to our project for assistance. It's called Fintrac—I don't know if anyone has heard of it—and they had to intervene with the director in Tegucigalpa to get this situation rectified.

Once they became registered, two important things happened. One, they got a bar code. That bar code allowed them to sell their products in supermarkets. All of a sudden the market that they faced expanded to a national market. The other important thing that happened is that they started paying taxes. Now, why would the Government of Honduras not register these folks when they are going to pay taxes on their enterprise? So this intervention by an outsider to get them registered had very beneficial effects for the country.

Why isn't the country taking those measures? I think that is one of the things that we are all struggling with is how do you get countries to improve the environments that people face so when they are entrepreneurial and productive, they can get to bigger and

bigger markets over time? And without easy entry into a formal economy, that is very hard to do.

It is a complex picture, as you were saying in your original remarks. There are a lot of things that need to be done, but a lot of what needs to be done, I think, is experimenting of the kind that you have talked about and getting policy environment such that people are encouraged to progress, can actually participate in their country's economy.

Ms. MCCOLLUM. Mr. Chair, if you would allow me just a second. Peace Corps is experimenting with doing that kind of technical assistance with governments and with businesses right now and in Mexico, but we are not seeing the expansion in dollars to allow Peace Corps to move forward on some of these initiatives. And the type of Peace Corps volunteer that volunteers for this kind of skill set is a different volunteer. And sometimes they only need someone to come in for 6 months or so, and they are asked in. We have some jurisdiction over Peace Corps, and at some point that might be for the Full Committee or Subcommittee to find out, to make the next step. The markets work, as Mr. Payne was talking about and as Mr. Smith was talking about.

Mr. SMITH. Could I add something? In Mexico, President Fox looked at the indicators in the Doing Business series of the World Bank and was aghast at how bad the environment apparently was in Mexico and asked USAID and the World Bank to come down. We are teaming with them to develop a plan with the cabinet in Mexico to improve the business climate in Mexico. So what we are doing at the cabinet level and with 13 cities, I think it is, around Mexico now, Peace Corps volunteers could certainly contribute to that kind of effort very effectively. Thank you.

Mr. SMITH OF NEW JERSEY. Mr. Fortenberry.

Mr. FORTENBERRY. Well, thank you for your testimony, Mr. Smith. We appreciate it.

If I could pull back to a higher level and ask you some overall questions about the basic objectives, and you laid some of this out in your opening statements and have touched upon it in answering questions here, particularly Mr. Tancredo's question. What are the overall strategic objectives for the microfinance program and how do those translate at the Bureau into the regions and then at the mission level?

The way I see it is basically threefold, and perhaps this captures it, perhaps it doesn't. If you could add to it, I would hope you would. First of all, it is economic assistance and justice for the poor; second, sustainable development; and third is the essential important policy goal of building relationships on a most fundamental level. If that doesn't accurately capture the overall objective, add to that statement what other policies are there or substantial goals are trying to be implemented through our programs, through our initiatives here. How well has Congress laid out those objectives for you? Could we do a better job?

Mr. SMITH. One of the immediate objectives, I believe, is improving the way that markets work. That relates to the poverty objective and to the overall security goal of countries that are prosperous, becoming more prosperous, are less likely to be enemies of the United States; or, as parts of their societies. It is hard to add

much to those basic objectives because they do cover so much. Sort of caught me at a loss of words.

Mr. FORTENBERRY. You can say I did it well.

Mr. SMITH. You did it very well, indeed. Thank you.

Mr. FORTENBERRY. If that is the larger 30,000-foot view of the basic overall goals of the programs, I think it is helpful to restate that. And again, you have laid some of that out in your earlier testimony, but to keep focused on that, again, if Congress can continue to implement that vision so that the clarity of directive is given to you as you proceed with your work, that is more the fundamental question. Is that objective clear?

Mr. SMITH. I think there is an area where, thanks to my staffer, if the Congress could be clearer about the primacy of economic growth as something to raise living standards in general. We have been focused on the poor for many decades, and where we have had the most success is where the overall environment is also improving. I think if there were a dedication to achieving growth throughout the world, it would—the studies say that growth is 90 percent of the question of reducing poverty. So if there is an economic growth focus that we intend to help countries grow, that would be an extremely important objective to clarify.

I think it is primordial. In a context of absence of growth, it is very hard, I would say it is impossible, to reduce poverty. That has, unfortunately, been the case in a lot of the African countries that we have been active in. I was fortunate, as you heard in the introduction, to be Deputy Director in Mozambique. Mozambique went from a basket case civil war, devastation, to a very rapidly growing country with a lot of investors coming in. And there is a lot of mystery as to why that continues to be the case because its commercial codes are terrible, and on paper it is not a good place to do business. But it has clearly welcomed investment and welcomed business. So they are growing rapidly. Now that they are in the habit of growing, I think that habit sort of reinforces itself.

We played an important role in Mozambique. I am very proud of what we did there. So if we could multiply those kinds of successes and get countries growing, we could do a lot more effective job of addressing the needs of the poor.

Mr. FORTENBERRY. That is always helpful in looking at a case study, a template, in which we are succeeding in this program as well as many others. There is obviously a lot of political, economic, and social infrastructure that goes—that is foundational before your programs can succeed.

Thank you again for your testimony.

Mr. SMITH. Thank you.

Mr. SMITH OF NEW JERSEY. Let me just ask a few additional questions, and then Mr. Payne has some additional questions as well.

First, on the issue of AIDS and the ongoing tragedy of AIDS, what kind of coordination is there or is contemplated with regards to our global AIDS coordinator, Ambassador Tobias? Is there any kind of effort to try to reach those who are helping, say, family members or AIDS orphans or the like to try to get some of this targeted to them?

Secondly, if you could just touch briefly on the issue of for-profits versus nonprofits. How do the overhead costs differ between the for-profits and nonprofits and whether or not—and if you could provide us, and this would be very helpful to expand our understanding this whole issue of the cutbacks and the impact it has had on your ability to manage effectively and efficiently these programs. It would give us a very good backdrop, minimally, to put a tourniquet on any further cutbacks in your personnel in missions abroad, but also to see how we could grow that again.

Getting back to that earlier request about your vision, what your hopes are, give it to us unfiltered, because it could be helpful to know where we can go with this.

And, finally, recently the Congress passed the CAFTA. Before CAFTA, the CAFTA vote, I went to El Salvador and spoke with a number of people from all walks, including government people, and it became very clear there are going to be winners and losers. The subsistence farmers were very likely to be very much disadvantaged and could be the ones who could benefit most if there were a stepped-up effort on microcredit loans and the like. I am wondering if any of that kind of work is being done to say, "Okay, we have a hole here now that is being created as a direct result of a policy enacted by them and us." As governments, what are we doing to fill that need? Is that something we are doing? Will more resources, for example, be going to El Salvador? I met with a number of church people, Catholic Church people and others, who were very concerned, and the government people did acknowledge it, winners and losers. These are the losers, but these loans could help.

Mr. SMITH. On HIV/AIDS, we have improved our assistance to vulnerable groups generally, including victims of HIV/AIDS. We have researched to better identify their unique needs. We have developed approaches to reach these groups. We have examples in a number of countries such as Zimbabwe, where we—that is not a good example anymore as a country because of the economic devastation that is going on there, but where we are using microfinance there to mitigate economic impact on orphans and others affected by the disease. I am not familiar with all of the mechanisms we have been using to coordinate with the HIV/AIDS office. Perhaps we could give you some other information about that in writing.

Mr. SMITH OF NEW JERSEY. Could I also add, if it is not being done robustly, I think that would be a very important bit of work to be done, and also at the Global AIDS Fund based in Geneva. Seems to me the more integrated this effort is, the better. I stand ready to be corrected if that is not the case, but it seems to be almost self-evident. I appreciate that.

Mr. SMITH. You also asked about cost-effectiveness and overhead rates and so forth. It turns out that it is not—these are not simple calculations, because different bases are used to provide overhead rates, and we are analyzing that now, and we will have information about that, as we promised, for the next report. And we would be glad to be in touch with the Committee about the work as it goes on.

In part, it is not always a matter of cost, it is a matter of through whom you get the right expertise. When you are dealing with the

Governor of the Central Bank, sometimes that expertise does reside only in a consulting firm. When you get to a lower level, you get a mix of where the expertise lies. It can lie in a WOCCU, for example, or in a consulting firm. Both are potential sources.

And we are analyzing all the data that I said we are working on to look very closely at that overhead rate issue and the overhead cost issue. It is a little hard to get at because it is also a question of getting proprietary information from firms about cost structures. We have them through the bids, but it can't be disclosed to the public because it is proprietary information. But we are working through all that so we can do the analysis and get a better handle on cost-effectiveness that way. I promise we are doing that.

Mr. SMITH OF NEW JERSEY. CAFTA.

Mr. SMITH. CAFTA and winners and losers.

Mr. SMITH OF NEW JERSEY. Whether or not, we are putting more resources to help the losers.

Mr. SMITH. We are concerned about the effects that CAFTA will have, although we believe the effects will be positive overall. It is true that there will be losers as well as winners. That is the capitalist system we know. It is a matter of destruction of the inefficient and promotion of the more efficient.

That is where I get back to what I was describing earlier, the kind of business environment that exists and the ability of countries to adapt more or less rapidly to changing circumstances. I believe that we are providing that type of assistance to improve policy environments. I think I would have to consult with my Latin America Bureau colleagues as to how exactly we are approaching the fact that there will be winners and losers within the economy and how we are adapting our programs to address the needs that arise because of that.

Mr. SMITH OF NEW JERSEY. If we could follow up on that, I would like to do it personally with you; because some of the people I met with, one of them had gotten under the aegis of the Catholic Church something on the order of $500,000, and they got that, I think, in 2000. And they have multiplied that many times over, but they said the need now has just become or would become, if CAFTA were enacted—and it has been enacted—or agreed to, they are going to have a number of people who will need these loans. Seems to me it would be one way of mitigating the damage that has been done to them by CAFTA. So I would love to work with you on that if we could.

Mr. SMITH. Okay.

Mr. SMITH OF NEW JERSEY. Mr. Payne.

Mr. PAYNE. Thank you very much.

In that same light, this question of winners and losers, and we do get into the efficiency question, and I commended Chairman Royce several years ago when he chaired the Africa Subcommittee, when it stood alone, that had a hearing on subsidies, agriculture subsidies in general, and how the U.S. and EU—I think the numbers dropped only to about $160 billion annually now; used to be up close to $300 billion of subsidies from EU and the United States. And Japan for their farmers and agriculture programs, which therefore mitigate against a developing country trying to

compete because of the governmental subsidies for agriculture products.

But on the same line that the Chairman was talking about, the winners and business, and it is a concern of mine because with the WTO, the Chiquita banana, which is a United States company but grows in Latin America, sued Britain on the Lome treaties that they used to let Dominica and those small Caribbean countries that did nothing else but grow bananas—the treaty said, we will pay a little more, we know we are paying more, but that is what we are going to do to our former colonies. And the Lome treaties allowed these little countries to have a flourishing banana trade even though their bananas were not as pretty as the Chaquita bananas and the ones that were done by the big United States firms in Latin America.

As you know, finally WTO did win over, and now Dominica and those little countries are no longer in the banana business because they have lost—they are not competitive with the megacompanies. There are winners and losers. The problem is there is nothing else they can do there in agriculture because, as you know, quotas and so forth. Things like sugar or coffee, it is a whole different ballgame. And I get concerned, too, about the losers because in those little countries now what is happening is some of our new legislation says if a person was born in a country, even though they were 6 months old, commits a crime, goes to our prison, they go back to those countries of origin. And so what is happening is people out of our prison system are going back to a little place like Dominica or whatever, and the big industry now has become crime and drugs and the things supplanting the agriculture programs. So I think that there are a lot of unintended consequences when these countries don't know what to do about these new situations they are being confronted with.

But just a question about your microenterprise. Do you do much with agriculture in small countries, places like we saw some projects in Ethiopia and Rwanda? They grow everywhere you can find a little plot of land. But are there programs where you are trying to get a bunch of small farmers to collectively put their products together and try to compete, for example, in coffee or in some of those products where collectively they can have a mass selling or at least a larger quantity than the individual farmers? Have you gotten into that in your microenterprise programs in agriculture?

Mr. SMITH. I am personally familiar with a project that CLUSA did in Mozambique where they had exactly that approach. They got a group of farmers together, not in just one area, in quite a few different areas over time; said, "What is it that you want to do, what is it you feel you are capable of doing?" And they developed a marketing of corn for those farmers, collectively, to buyers. Had to overcome this issue of being a legal entity and to be able to enter into contracts. They did overcome those issues and made it possible for farmers to realize about 40 percent higher prices as collective sellers of corn, just like the cooperatives in the Midwest. Now that wasn't a microenterprise program per se, but it was—it has those kinds of characteristics. Let me ask my colleague.

Well, I think we should probably give you some data on that very question because my colleague has told me we are increasing work

in agriculture, and that is part of the increase that I talked about to over $200 million in microenterprise development. So agriculture is clearly the driver of growth in Africa. Can be.

Mr. PAYNE. Absolutely.

Mr. SMITH. So we are very cognizant of that.

Mr. PAYNE. Thank you very much.

I would like to follow up on that because I do believe that to prevent the continued migration to cities, where there is just not employment around, if somehow we can keep people in the rural areas, and there would be some programs that would be beneficial, I think that would be a trend, stopping the urban plight that you find in cities and in shantytowns that are built around the cities because they don't have adequate housing and no jobs, and then crime and the rest. But if we could have a real agriculture program, even if it starts small and just continues.

There is a very exciting program that I went about a week ago to an announcement of the Millennium Promise, which a New Jersey person I am very proud of, his name is Ray Chambers, very philanthropic person, has gotten together with Dr. Jeffrey Sachs and Angelina Jolie. I met her, and can you believe I forgot her name? I remember the doctor's name, so there is nothing wrong with this picture. Anyway, they are taking 100 villages where they are actually—they showed the result of just some fertilizer and microenterprise and people coming together, and showed a video of the success there. And Ray Chambers, you know Ray, is going to have a goal of having 100 of these little village projects by the end of this year, which is just astounding with this little microenterprise.

And I was also at the U.N. when the President spoke, and I am glad he mentioned agricultural subsidies, which is the first time that has been spoken about. So if we are going to work toward a level playing field, that is one thing I think we have to deal with as relates to rural poverty wherever it is in Asia, Latin America, or in Africa. Thank you.

Mr. SMITH. Thank you.

Mr. SMITH OF NEW JERSEY. Mr. Smith, thank you so much for your testimony. The Committee looks forward to working with you going forward, and have you back again real soon. Thank you again.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. SMITH OF NEW JERSEY. I would like to now welcome our second panel to the witness table, beginning with Dr. Jonathan Morduch, who is Associate Professor of Public Policy and Economics at New York University, where he teaches international economic development at the Robert Wagner Graduate School of Public Service. He is the author of *The Economics of Microfinance*, and he has written on insurance markets, safety nets, foreign aid, and dynamics of poverty. Professor Morduch serves as Chair to the United Nations Steering Committee on Poverty Measurement, and he has been a consultant for the World Bank and the U.S. Agency for International Development (USAID). He is currently an advisor to the Board of Pro Mujer, an innovative provider of microcredit in Latin America. Professor Morduch has taught on the economics faculty at Harvard University, was a national fellow at the Hoover In-

stitution at Stanford University, and was a MacArthur Foundation Research Fellow at Princeton University. In 2002 to 2003, he was an Abe Fellow at the University of Tokyo.

We will then hear from Susy Cheston, Senior Vice President for Policy at Opportunity International, a nongovernment organization that aims to provide greater access to microfinance and AIDS programs to help the poor. She is Co-Chair of the Microenterprise Coalition and also Executive Director Emeritus of the Women's Opportunity Fund, a member of the Opportunity Network. In 1991, she followed a call to work with the poor and volunteered with the ACCION International affiliate in Costa Rica. Ms. Cheston has co-authored *Measuring Transformation: Assessing and Improving the Impact of Microcredit*, which was presented at the Microcredit Summit Meeting of Councils in the Ivory Coast and was published in the premier issue of *The Journal of Microfinance*. She has also co-authored *Empowering Women through Microfinance*, and has written a number of articles on women and microfinance.

We will then hear from Mr. Gary Plank, who is Chairman of the Board of the World Council of Credit Unions, which represents the U.S. credit union movement as a delegate of the Credit Union National Association. First elected to the board in 1997, Mr. Plank was elected Chairman in 2005. He is also the Chairman of CUNA's World Leadership Development Committee. Mr. Plank has been President and Chief Executive Officer of the Arizona Credit Union League since 1997. He has held the same position at the Minnesota League of Credit Unions from 1983 to 1996. Mr. Plank was a member of the CUNA's Executive Committee and the board of directors from 1993 to 1997.

We will then hear from Mr. Lawrence Yanovitch, who currently serves as Director of Policy and Technical Assistance at the Foundation for International Community Assistance, a global network of local institutions that provide business loans to low-income clients in developing countries. As a founding member of the FINCA management team, Mr. Yanovitch has helped to lead the organization's extraordinary growth. In 1992, when he joined FINCA, he served some 6,000 clients; today over 300,000 clients, and processes nearly 1 million loans with a 97 percent repayment rate. Since 1999, Mr. Yanovitch has worked with Queen Rania of Jordan on championing the cause of opening financial markets to the world's poor, particularly women. Mr. Yanovitch is currently working with Her Majesty on a campaign for advancing peace in the Middle East through women's economic empowerment as part of a G–8 initiative. He was elected by representatives of 22 governments as a member of the Policy Advisory Board of the Consultative Group to Assist the Poorest, a World Bank initiative. He founded the Campaign for Global Leadership, the leading advocacy group for increasing the budget for international affairs. Mr. Yanovitch is a board member of the Microfinance Technology Project led by Hewlett-Packard.

We have a very, very august group of witnesses here, and are very, very grateful you have taken the time to lend your expertise and words and counsel to the Committee. Thank you for being here. And we will begin with Dr. Morduch.

STATEMENT OF JONATHAN MORDUCH, PH.D., ASSOCIATE PROFESSOR OF PUBLIC POLICY AND ECONOMICS, ROBERT F. WAGNER GRADUATE SCHOOL OF PUBLIC SERVICE, NEW YORK UNIVERSITY

Mr. MORDUCH. Thank you. Chairman Smith and Members of the Committee, thank you for this opportunity to appear before the Committee. And I want to take this opportunity first to thank the Chairman and the Committee for your continuing efforts to work toward a world with less poverty, with greater opportunity, and with stronger accountability for foreign aid spending.

I want to ask that my full testimony be entered into the record, and I will then briefly summarize.

Mr. SMITH OF NEW JERSEY. Without objection, Doctor, yours and all of our witnesses' statements will be made part of the record.

Mr. MORDUCH. My comments today reflect over 15 years of research on microfinance and poverty measurement. In addition to my position at the NYU Wagner School, I have the privilege of serving as the Chair of the United Nations Expert Group on Poverty Statistics, and also I am a member of the expert advisory committee for the University of Maryland IRIS Center project to implement the poverty assessment component of the legislation under review today.

Advocates of various stripes have brought passion, new evidence, and new ways of thinking to make microfinance a global phenomenon. In this process, decades of pessimism and misinformation have been pushed back. Microfinance today stands as one of the most promising and cost-effective tools to fight global poverty.

A few months ago I was looking back at some old congressional testimony from 1986 at which the founder of the Grameen Bank testified before Congress. He was joined by Jeffrey Ashe, at that point the Research Director of ACCION International. It was striking to note that at that point Grameen Bank had fewer than 100,000 members. ACCION International had not yet become a global international network, and yet today Grameen Bank serves over 3 million clients in Bangladesh, and ACCION International is a major force. And in Bangladesh alone there are between 10- and 12 million clients.

The growth of microfinance over the last two decades has been really a powerful example of what can happen when donors and social entrepreneurs and committed individuals come together. And so I want to especially thank the Chairman and other Members of the Committee for the kind of commitment to microfinance that has made all of this possible.

But now with microfinance firmly established, especially this year with U.N. marking the International Year of Microcredit, it is the right time to step back to discuss what we have learned so far, to try to determine what we could know better, and to figure out how to move forward together. The present legislation, in creating a mandate to collect data on who microbanks actually are serving—and this is the first time this has actually been done in a systematical way—is already proving extremely valuable. I want to talk about some preliminary results from these efforts. I have four points that I want to make briefly this afternoon.

The first is that there is clear evidence that microfinance can work for the very poor. The second is that microfinance can be powerful and cost-effective, but it is not a panacea. Setting expectations too high risks, in my mind, undermining the genuine contributions that access to finance can bring. Third, preliminary evidence so far suggests that reaching the target set by the legislation will be a challenge. And I want to discuss what we are learning so far. We are learning a lot through the provisions of the legislation.

And the fourth point I want to briefly touch on is that international donors like USAID have a crucial role to play at this juncture, even when it seems that the push toward commercialization of microfinance would suggest donors should become less relevant. In many ways this is a really important time for microfinance and donors to have a critical role to play, especially in pushing for propoor innovation.

My first point is microfinance can work for the very poor. We have learned that a broad range of people are eager to become microfinance customers, both among the poor and the non-poor. Most microfinance customers today live on incomes that put them either a few notches above national poverty lines or just below the lines. These are not the very poor as defined by the legislation. The legislation has an important role in trying to expand the scope of microfinance to a customer base that is unserved.

The question is, what is the possibility for doing that, and how big is the group of feasible borrowers among the very poor as defined by the legislation? And what I want to underline is that indeed there is a large group of very poor who are feasible borrowers, and we are learning this in various ways. At the same time, of course, non-poor borrowers can do great things with microfinance, and it is very natural for them to be the main customer base for microfinance. They are a bit better connected to their local markets, they have more resources in general and are able to take advantage of microfinance in a variety of ways, and they themselves need the help to gain a stronger economic foothold.

So I want to just briefly review two studies that I have been involved in that speak to this issue of microfinance and the very poor. The first comes from work I have done with Bank Rakyat in Indonesia, which is one of the world's most innovative microbanks. They now serve over 30 million clients and customers in Indonesia. A lot of them are savers, many of them are borrowers, but most of their clients are not the very poor. They are above the poverty line or close to the poverty line.

But BRI, Bank Rakyat Indonesia, was interested in knowing whether they could reach down deeper, and so they decided to do a survey across Indonesia of people they weren't serving, and part of the survey then asked about the creditworthiness of the different people who were enumerated. And the survey was large, about 1,500 people.

What we learned from that survey was that among the poor as defined by Indonesia's poverty line, about half of the people below the poverty line were judged to be feasible as customers of microfinance institutions. If we went down further to people who are under half of the official poverty line—we are talking about people who are living on under roughly 18 cents per person per day in

rural areas, these are very poor poverty levels—even half of this group was judged to be feasible as customers. People who had worthy projects were able to take loans and were able to pay them back.

So the idea that very poor customers can be feasible, can be reliable, can take advantage of loans is made clear by the survey, made clear by the work that we see in other places, but this is a large group that is underserved. This is why the legislation to me is so important to push pro-poor innovation to reach more among this group. I will talk in a few minutes about what we know about who is actually being served.

The second study, briefly, looks at 124 programs in 49 different countries, so it is a bird's-eye view of who is being served by microfinance, and we are learning from that data set about a different set of questions. Is it possible to serve poorer clients and still make profits? But we are learning that it is hard, it is hard to reach down and still make profits, but it is indeed possible.

The data suggests that reaching the very poor while making profits is within sight, but it is not easy. It takes time. And even for the best established providers, it continues to be a struggle. And this is one reason, as I underscored before, one reason that continuing support from international donors is pivotal and why pro-poor innovation is still very much on the table.

The second point, briefly, is that microfinance is powerful, it has been proven to be powerful, and has proven to be cost-effective, but it is not a panacea. I think it is important to keep that within sight. We have recent evidence, for example, from a large survey in Bangladesh that shows that microfinance has considerable promise in reducing poverty, particularly extreme poverty. We don't have that kind of data from a broad range of countries, and so we are still waiting to learn more rigorously about the social impacts of microfinance, but what we know so far is very promising.

I expect when the surveys are completed that we will find that microfinance alone is not a panacea and cannot eliminate the kinds of constraints faced by the very poor, and in many ways this echoes the comments that were made earlier today, constraints that are multiple and overlapping, including lack of access to adequate health care, sanitation, and drinking water. But microfinance can be an important part of solutions, and it should be seen in that light as an important part of the solutions. It can provide financing, for example, through saving accounts, loans, most recently through microinsurance programs. It also provides an opportunity to bundle financial services with cost-effective education, for example, on good health practices.

One practitioner, Pro Mujer, which is an innovative microlender in Latin America, is going one step further and, in response to feedback from their clients, actually providing health services such as gynecological exams with an eye to cancer prevention and detection through their programs. Last year alone, Pro Mujer in Nicaragua detected 199 cases of cancers among their customers, cases of cancers that would not have been otherwise detected, and Pro Mujer was able to link these very poor women to treatment.

So such integrated models of banking, coupled with social services or other services, can work. They are not appropriate for all

times or all institutions, they are not easy to implement, but they show considerable promise when done correctly and when focusing on the poorest. It will be important, but it is not a miracle cure.

The final major point I want to make is that reaching the legislative targets will, in my estimation, prove to be a challenge. The legislation targets that half of funding will go to the very poor with specific standards of what it means to be the very poor. This is an important step forward. The kind of clarity that we have through the legislation has not been there before, and it has been very helpful.

So I have been involved through the University of Maryland IRIS Center project in actually implementing this part of the provision, and what we are finding is that the kinds of tools that we can develop or that they have developed so far have quite good levels of accuracy. That is very promising. It turns out they are surprisingly difficult to develop, but that is really at the R&D stage. At the implementation stage, they should be quite simple for practitioners to actually use, and that follows the mandate of the legislation.

But I just want to flag two things looking ahead. The first has to do with ongoing technical debates around poverty measurement methods. Those I am not going to touch on now because I am going to leave them to my written record. They are general issues that aren't specific to microfinance.

The second I want to touch on briefly is—which has to do with the preliminary results on poverty levels of existing microfinance customers. I will skip to that. I just want to briefly remark that in the four countries that have been studied by the IRIS Center at the University of Maryland—these are Bangladesh, Peru, Kazahkstan, and Uganda—as part of the USAID effort, the IRIS Center completed independent surveys in these countries. These were big surveys, and they aimed to find out how poor customers were. This had not been done before. It is really the first time, and it is thanks to the legislation that this has happened.

What we are learning so far is at this point relatively few microfinance customers across these countries are below the established cut-offs for being very poor. In Bangladesh, which was a place with the greatest number of people below the line being among the very poor, about 44 percent were—of current microfinance customers, and this is across about 45 different institutions—about 44 percent of them were found to be under the relevant cut-offs. So if USAID put all their money into Bangladesh and put it onto these 45 NGOs, it still wouldn't make the targets.

In Peru, between 4 and 17 percent fell below the cut-offs; in Kazahkstan an even smaller number; and in Uganda about 15 percent of microfinance customers would be designated as very poor, according to the legislation.

Now this is data on current microfinance clients, so there is a caveat because, of course, some of the clients may have started out poorer and then through microfinance grown richer, and thus they are not among the very poor today. That is a very positive story. We don't know enough to get a sense of the extent to which that is true. I only wanted to flag that the targets are challenging, and we should bear that in mind as we go forward. If the targets were easy to meet, of course, there wouldn't be anything gained from leg-

islating targets. That is why we have targets. And I believe in challenging targets, but I only want to underscore that they are indeed challenging.

Finally, I just want to close on a quick note on USAID's role. USAID has been a leader in learning and knowledge generation around microfinance. It should continue to be. In the last few years its role as a leader here has been diminished, but rigorous evaluations—and basic research are public goods. USAID can make a big difference by regaining that part of its portfolio in a major way.

There is also an important role, I believe, in directly supporting microfinance practitioners who work with the poor and very poor, as I said earlier, through pro-poor innovation. And at this time the commercial part of microfinance is moving ahead quickly, and that is very promising, but as the data I have laid out in the last few minutes has suggested, we still have challenges. And this is where USAID and its support for direct service providers can be critical.

Thank you very much for allowing me to share my views.

[The prepared statement of Mr. Morduch follows:]

PREPARED STATEMENT OF JONATHAN MORDUCH, PH.D., ASSOCIATE PROFESSOR OF PUBLIC POLICY AND ECONOMICS, ROBERT F. WAGNER GRADUATE SCHOOL OF PUBLIC SERVICE, NEW YORK UNIVERSITY

Chairman Smith, Members of the House International Relations Subcommittee on Africa, Global Human Rights and International Operations, thank you for this opportunity to appear before your committee. I want to take this opportunity to thank the chairman, and the committee, for the continuing efforts to work toward a world with less poverty, greater opportunity, and stronger accountability for foreign aid spending.

I am honored to be here to discuss the important legislative efforts to promote microfinance and microenterprise. I would like to ask that my full testimony be entered as part of the record, and I will then briefly summarize my major points.

My comments today reflect over fifteen years of research on both microfinance and poverty measurement. In addition to my faculty position at the NYU Wagner School, I have the privilege of serving as chair of the United Nations Expert Group on Poverty Statistics, a group of international experts and practitioners working to improve the measurement and understanding of global poverty. I am also a member of the expert advisory committee for the University of Maryland IRIS Center project to implement the poverty assessment component of the legislation under review today.

Advocates of various stripes have brought passion, new evidence, and new ways of thinking to make microfinance a global phenomenon. In the process, decades of pessimism and misinformation have been pushed back. Microfinance stands as one of the most promising and cost-effective tools in the fight against global poverty. Microbanks like the Jamii Bora Trust now give hope to residents of the sprawling slum of Kibera, Kenya, one of world's largest and bleakest slums. I have visited successful microfinance customers living in make-shift huts built on stilts over fetid water in the slums of Bangladesh, and heard customers excitedly tell of their new businesses in poor villages in South India. Thanks to hard-fought campaigns, microbanks now serve tens of millions of poor and low-income customers in Kosovo, in Afghanistan, throughout sub-Saharan Africa, and in many other parts of the world. Accion New York even serves over 6,000 customers in the New York metropolitan area.

In pushing to make all this happen, the rhetoric has sometimes been heavy and the hopes extremely high. Now, with microfinance firmly established—marked with a special UN International Year of Microcredit in 2005—it is the right time to step back and discuss what we've learned so far, what we would like to know better, and how we can move forward together.

The present legislation, in creating a mandate to collect data on who microbanks serve today, has already proved extremely valuable. And the effort will be even more valuable as additional data are collected and analyses push ahead.

I want to focus on four points this afternoon:

First, there is clear evidence that microfinance can work for the very poor. Many among the very poor actively seek better ways to borrow, save, and purchase insur-

ance—but find themselves too often rebuffed by state banks or traditional commercial institutions. Not all would make reliable customers, but microfinance practitioners have demonstrated that it is possible to serve large numbers of the very poor. The present legislation underscores the importance of trying to better reach this population.

Second, microfinance can be powerful and cost-effective, but it is not a panacea. The World Bank finds that over one sixth of our planet live on income less than $1 per person per day. It is easy to lose sight of the human struggles that lie beneath these numbers—struggles complicated by poor health, inadequate nutrition, limited education, and vulnerability to shifting economic, political, and environmental conditions. Microfinance cannot fix all of these problems. Microfinance can be a powerful and cost-effective strategy that complements other interventions, but it is not a miracle cure. Setting expectations too high risks undermining the genuine contributions that access to finance can bring.

Third, preliminary evidence so far suggests that reaching the targets set by the legislation will be a challenge—specifically the target of spending half of the USAID microenterprise budget on the very poor. I say this without specific knowledge about USAID's disbursements. My prediction stems only from preliminary (and limited) evidence that few existing microfinance institutions currently serve customer populations that are predominately drawn from the very poor as defined by the legislation. These patterns are unlikely to change in the short-term. Of course, if meeting targets was easy, there would be little gained by legislating targets, and part of the intent of the legislation, as I understand it, is to encourage the development of new ways to reach the very poor with financial services. The findings, if confirmed by subsequent data collection, underscore the continuing importance of pro-poor innovation.

Fourth, international donors like USAID have a crucial role to play at this juncture, even when the push toward commercialization suggests that donors should become less relevant. Donors can and should play a key role in continuing to spur innovation for those still poorly-served, enabling a strong macroeconomic and policy environment, supporting basic research questions relevant to policy and practice, and directly supporting microfinance practitioners who work with the poor and very poor.

I. MICROFINANCE CAN WORK FOR THE VERY POOR.

Debates continue around which customers can best take advantage of microfinance. Fortunately, the answer is that a wide variety of groups can do so in different ways. Financial markets in poor communities still have too many gaps, and a broad range of people are eager to become microfinance customers, both among the poor and non-poor. Most microfinance customers today live on incomes that put them a few notches above their national poverty lines or just below the lines—not the very poor as defined by the legislation. These are low-income households struggling to establish a firm economic foothold, and they are often a vital (and large) part of economies.

The Microenterprise Results and Accountability Act recognizes the broad scope for microfinance by not targeting 100 percent of microenterprise funds to the very poor. Instead, the legislation targets half of funds toward the very poor. Some microfinance experts have wondered, though, whether the very poor can be reliable clients at all. Evidence from India and Bangladesh, where many microfinance customers are very poor according to the legislation's definition, show that the answer is definitely yes. Evidence from other countries is less clear, in part because microbanks seldom collect complete data on the income levels of clients and in part because the "very poor" segment of the market is often small and not yet served extensively by microfinance.

Lessons from Indonesia: many un-served customers may still be "feasible" borrowers. Several years ago I advised a project that attempted to address these questions head on. In August 2002, Bank Rakyat Indonesia (BRI), a pioneering microfinance provider, now serving over 30 million customers, undertook a survey in part to gauge whether the very poor could be feasible customers. The survey covered 1438 households in six provinces. At the time of the survey, nearly all of BRI's customers were close to the poverty line or above it. BRI initiated the survey in part to better understand possibilities for working with clients poorer than their existing base.

The survey had one unusual feature. Instead of hiring an outside survey firm, BRI looked in-house for survey enumerators—the people who would go door-to-door asking questions of the 1438 households in the sample. The enumerators were thus

mostly BRI loan officers or book-keepers, and most in this group had extensive professional experience judging credit applications.

The survey included detailed information on the households' credit, assets, savings, household businesses, and economic and social changes. The use of loan officers and book-keepers as enumerators provided a unique opportunity to assess the creditworthiness of both customers and non-customers using the standard procedures applied by the bank. At the end of each survey, the enumerators were asked to give their professional assessments of the creditworthiness of each household, whether or not someone in the household was presently borrowing (or even interested in borrowing).

The poverty line in Indonesia at the time was roughly 36 cents per person per day in rural areas, and 48 cent per person per day in urban areas (converted at official exchange rates). The enumerators reported back that roughly half of the poor households surveyed would, in their professional judgment, be appropriate for a BRI loan. Moreover, roughly half of the households living on income equivalent to *half* of the official poverty line or less (i.e., on under 18 cents per person per day in rural areas) were also judged to be feasible BRI borrowers. Few were currently microfinance borrowers, though. Thus, in Indonesia there appeared to be a large group among the very poor who were under-served by microbanks but who were nevertheless potentially reliable customers—as judged by BRI professionals themselves.

Trade-offs in serving the very poor: reaching the very poor is costly but viable. The enumerators in the Indonesia survey described above were judging whether the households seemed reliable, able to repay loans on time, and able to pay the same interest rates as existing customers of BRI, a leading commercial bank. The enumerators found many very poor households that qualified.

It is another thing to ask whether the bank would have been able to profit while serving these very poor customers. Since the scale of lending is typically smaller when serving the very poor, profits can be difficult to squeeze out. In addition, to reach the "feasible" half of the poor population, BRI staff would have to find inexpensive ways to determine who was in the half that was deemed a good prospect for repaying loans, and who was not. BRI is experimenting with ways to achieve these goals cost-effectively.

We can step back and ask a broader question: across successful microfinance institutions world-wide, is there evidence of a clear trade-off between profitability and the ability to reach the poor?

The answer is mixed, but hopeful. With two co-authors in the research department at the World Bank, I have been investigating a data set with unusually high-quality financial information on 124 microfinance institutions in 49 countries. These institutions are united by claiming strong commitments to achieving financial self-sufficiency and a willingness to open their accounts to careful scrutiny. The institutions thus represent some of the best hopes for achieving poverty reduction with profit (or at least without ongoing subsidy).

The data set does not include information on how many clients of each institution are "very poor" as defined by the present legislation, so proxies for poverty levels are used instead, mainly based on average loan size.

We find several interesting results here. First, the survey shows little correlation overall between profitability and average loan size. Average loan size is taken as a rough proxy for the average poverty level of customers, so this finding suggests the possibility of serving the very poor on a financially viable basis.

The survey allows us to dig a bit deeper. We start by noting clear differences across institutions associated with their lending methods. For example, microbanks using a "village banking" model pioneered by FINCA make the smallest loans ($149 per borrower in 2003). (These are not all affiliates of FINCA and their specific lending methods may vary.) Microbanks in the sample that use "individual lending" methods, similar to standard commercial bank practices in the United States, make much larger loans on average ($1220 on average). These are still small loans, of course, relative to the size of loans made by typical banks.

The survey shows that the village banks, not surprisingly, face high costs per dollar lent. This is in large part because banks that make the smallest loans run into limits in the economies of scale that can be reaped.

The "individual lending" group is profitable on average, with revenues covering 111 percent of their total costs (over 100 percent indicates profitability). The "individual lending" group demonstrates the possibility of financially sustainable microfinance. The high costs faced by the village banks as a group mean that they were covering just 95 percent of their total costs—which is still impressive but not yet fully profitable.

These are averages, and they cover up that some village banks are already profit-making while others are not. Taken as a whole, most of the microbanks in the sam-

ple have steadily improved their financial positions over time, and the financial performances can be expected to improve in future years for everyone. The data suggest that reaching the very poor while making profits is within sight—but it is not easy and takes time, even for this group of industry leaders. This is one reason that continuing support from international donors can be pivotal.

II. MICROFINANCE IS NOT A PANACEA.

Many social and economic interventions lack a broad range of rigorous evaluations with high statistical standards. The lack of serious evaluations is common in the health and education sectors, for example, and the microfinance sector is no exception.

We have many compelling stories about transformations brought by microfinance, and good theoretical reasons to expect that microfinance is a powerful intervention in practice. Recent evidence based on large comprehensive surveys in Bangladesh, for example, show microfinance's promise, particularly in reducing extreme poverty. We still await rigorous evidence on microfinance impacts from a broad range of countries, and international donors have a potentially pivotal role to play here as well.

When better surveys are completed, I expect that we will find that credit alone is not a panacea that can eliminate all of the constraints faced by the very poor. Those problems and constraints are often multiple and overlapping, including lack of access to adequate healthcare, sanitation, and drinking water.

But microfinance can be an important part of solutions. It can be a way to help finance health needs, for example—through savings accounts, through loans, and, most recently, through health insurance programs. Microfinance practitioners like Freedom from Hunger explicitly bundle credit provision with cost-effective education on good health practices, and they have demonstrated improvements in their customers' health as well as wealth.

Pro Mujer, an innovative microlender in Latin America, is an example of an instution that has gone one step further. Based on feedback from their clients, Pro Mujer Nicaragua introduced an array of health services including gynecological exams, with a focus on cancer prevention and detection; self-help groups aimed at combating family violence; and health counseling by clients trained as health promoters. In 2005 Pro Mujer Nicaragua began an innovative strategy to take health services straight to customers' communities. Health educators now travel by motorcycle to communities, offering pap smears and consultation services. Last year alone, 199 cases of cancer were detected among Pro Mujer's customers in Nicaragua, and the women were linked to treatment.

Such integrated models of banking coupled with social services (or other services) are not appropriate for every microfinance institution or every location—or even most institutions and locations. Nor are they simple to implement. But they show considerable promise when focusing on the poorest.

III. REACHING THE LEGISLATED TARGETS MAY PROVE TO BE A CHALLENGE.

The Microenterprise Results and Accountability Act of 2004 establishes an effort to collect data on the poverty levels of microentrepreneurs served with USAID funds. The initiative is a major step forward, both for the microfinance community and for taxpayers who deserve accountability about the social impact of government spending.

I have been involved, as a member of the advisory committee, in the effort to create simple methods for assessing the poverty of microfinance customers. Real progress has been made by the team based at the University of Maryland IRIS Center, and it has been a privilege to be part of the process. In many of the countries where the methods are being developed, the poverty assessment tools so far have quite good levels of accuracy.

Looking ahead, at least two issues are being kept in mind. The first has to do with ongoing technical debates around poverty measurement methods—issues that are general and not specific to microfinance. The second has to do with the preliminary results on the poverty levels of existing microfinance customers.

A. Technical debates about poverty measurement.

Most countries measure poverty according to their own methods, reflecting their own policy concerns and national conditions. The legislation being discussed today identifies very poor people according to two specific criteria: either people living under the "international poverty line" of $1 per day per person, or people in the bottom half of their country's own poverty distribution—literally, the poorest of the poor.

The specificity around the notion of the "very poor" is very helpful. The definitions reflect the aspirations of many in the community of microfinance practitioners and policymakers, and it is unlikely that wide-scale pro-poor innovation will occur without concrete steps like this.

From a purely technical standpoint, things are seldom as simple as they seem at first crack, though, and I highlight two hurdles considered so far in implementing the legislation. Fortunately, neither hurdle is insurmountable, but they suggest how implementing the legislation may require extended support from experts skilled in survey design and poverty analysis. I preface these views by noting that these are my personal opinions, and they may not be shared with others involved in the project.

Issues with the $1/day poverty lines. The international poverty line is a simple metric that has generated a wide consensus. But it has also been subject to some debate among practitioners and academics. One of the main tensions centers on the method of translating "$1/day" into the local currencies of countries in question. The method used is the "purchasing power parity" (PPP) exchange rates that were developed to put the value of GNPs across the globe onto comparable scales. Because official exchange rates are often distorted by policy or other interventions, the PPP exchange rates can give a clearer view of the standards of living in different countries. For this reason, they are increasingly used in making worldwide comparisons.

The PPP exchange rates were not specifically designed for comparing poverty levels, though. They are preferred in this setting over using official exchange rates, but they have limits. The most important limit here is that the PPP exchange rates do not reflect the kinds of goods and services typically consumed by the poor and very poor. They exchange rates tend to put too little weight on basic staple foods and too much weight on luxury goods and items like cars and color televisions. Efforts are underway to refine the PPP exchange rates with poverty comparisons in mind, and preliminary evidence from India and Indonesia suggests that the refinements may make a considerable difference in who is judged poor and who not.

The legislation is based, rightly, on using the best-available methods, but it is worth noting that the methods are still being developed, and I hope that a more reliable set of numbers will emerge within five years.

Issues with the "poorest of the poor" criterion. The idea is to define the very poor as those households in the bottom half of the distribution of poverty in a given country. In statistical terms, the idea is to distinguish between households above the median income (the middle point of the distribution) and those below the median income of all poor households. In some countries the median income of poor households is easy to obtain or approximate. Where nationally-representative surveys of incomes are available, it is an easy number to calculate.

A tension, from a purely practical angle, is that relatively few countries (particularly among the poorer countries) make nationally-representative surveys available on a routine basis. The surveys are often hard to obtain even on a non-routine basis.

The median income of the poor is also seldom published in official tables. In my role with the United Nations committee on poverty measurement, I have come to see the value of broader access to data and of publishing a wider array of poverty statistics (including median incomes). But neither is the case today, and researchers will have to take creative steps to approximate where the appropriate cut-offs are in places where the relevant data are unavailable.

Again, the hurdle is surmountable and the University of Maryland IRIS Center team has done an excellent job in showing how. Extending the process to other countries will require expertise and resources, and USAID should be prepared for this possibility.

B. Who is being served today?

In the course of their work, the team from the University of Maryland has collected data on the poverty levels of microfinance customers in four countries: Bangladesh, Peru, Kazakhstan, and Uganda. The lessons learned so far are revealing in themselves—and have emerged thanks to the provisions of the legislation.

The results are preliminary and based on relatively small samples, but I want to highlight a few findings. The microfinance institutions surveyed reach poor and low-income customers who can benefit from the services provided.

At this point, though, relatively few current microfinance customers in the survey (in these three countries) are below the established cut-offs for being "very poor."

In Bangladesh, nearly 350 current microfinance clients were surveyed, and 44 percent were found to be under the relevant cut-off.

In Peru, nearly 1200 microfinance customers were surveyed, and none were below the $1/day international poverty line. Between 4 and 17 percent fell below the second cut-off, being in the bottom half of the income distribution.

In Kazakhstan, an even smaller group of customers was found to be below the established cut-offs, which is understandable in part given the relatively low poverty rate in the country (16% in 2004).

In Uganda, in a sample of 788 households, 40 percent were identified as current microfinance customers. Of these, 15 percent would be designated as "very poor" according to the cut-offs in the legislation.

Caveats and comments. In Bangladesh many current microfinance customers likely started out among the very poor and have since grown less poor. To some extent, this is also likely elsewhere. Data on incoming microfinance customers (rather than current customers in aggregate) should show higher levels of poverty if that is true, but at this point I can only speculate.

Also, again, these data are just from four countries and pertain to relatively small samples.

If the patterns hold up, though, it will be a challenge to reach the targets set by the legislation. Of course, if meeting targets was easy, there would be little gained by legislating targets. The most important lesson I take from the findings (if they are confirmed by future data collection) is that pro-poor innovation continues to be important for microfinance—and suggests an important ongoing role for USAID.

IV. USAID'S ROLE.

The emerging successes of commercially-oriented microfinance might suggest that international donors should play a smaller role in this sector. The evidence so far, though, suggests that microfinance is still not reaching the target population of "very poor" customers highlighted by the legislation. To reach this goal, several activities seem critical, and international donors like USAID can take the lead in:

1. *Helping establishing sound macroeconomic and regulatory environments* in which microfinance can grow.
2. *Spurring pro-poor innovation* through challenge grants, and helping to get innovations to a wide scale.
3. *Supporting basic research questions relevant to policy and practice.* Rigorous evaluations are "public goods" and tend to be under-provided. They also can require financial and technical support beyond the capacity of microfinance providers focused on the very poor. A range of other basic questions about pricing and policy remain relatively unexamined. International donors like USAID have the position to play a leading role in helping institutions (and the broader industry) learn from successes and challenges.
4. *Directly supporting microfinance practitioners who work with the poor and very poor.* The support from international donors has been essential for microfinance institutions as they have pushed to reach new markets, tried new and better products and processes, and reached scale. The growth of microfinance is a testimony to the power of those investments. Established providers that are entering new markets and seeking to serve difficult-to-reach customers continue to need support in order to reach the full promise of microfinance.

Thank you very much for allowing me to share my views on these important topics.

Mr. SMITH OF NEW JERSEY. Thank you very much.

Mr. PAYNE. Can I make some real quick comments? When you were talking, I thought you were saying "bankrupt Indonesia," but I looked at the text and it says "Bank Rakyat." Thanks. I was a little nervous. I didn't know what you were running here.

Mr. SMITH OF NEW JERSEY. Ms. Cheston.

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

Ms. CHESTON. Good afternoon. I am very grateful for the opportunity to testify today. And, Mr. Chairman, on behalf of Opportunity International and the entire Microenterprise Coalition, I would like to express our gratitude to you, our heartfelt gratitude, for all you have done through your leadership on microfinance on

behalf of the poor. And with your permission, I would also like to present summary remarks.

When I was working with the Women's Opportunity Fund as a loan officer to poor women in El Salvador—the best job I have ever had in my life—in the early 1990s, I never dreamed that by 2003 the Microcredit Summit Campaign would report that over 80 million clients were being reached and moving toward self-reliance with the help of microloans. This is extraordinary progress in just over three decades. And this phenomenal success, now that we have figured out our systems, figured out our methodologies, means that we are poised to reach millions of more clients today who are not currently served by microfinance.

The results are worth fighting for. The results can include increased income that leads to better schooling for girl children and boy children, better housing, money to pay for health care when it is needed, even decreases in domestic violence, and the ability to care for orphans. So the question before us today is, do you want to let microfinance stagnate, or do you want to invest in success and finish the job?

In the past 5 years, Opportunity, my organization, has grown by 460 percent. We are now reaching 770,000 loan clients alone, with 2 percent arrears, full sustainability, reaching 87 percent women and providing an average initial loan size outside Europe of US$80.00. By 2010, we expect to be reaching 2 million clients with loan services and additional clients with savings and microinsurance, training in business skills, leadership development, HIV/AIDS prevention and the like.

Our major focus for expansion, this Subcommittee will be glad to hear, is Africa, and particularly those countries with a high incidence of HIV/AIDS. Over the next 10 years, we plan to build commercial financial institutions—banks for the poor—in 16 African countries, and our goal is to empower millions of poor women to avoid risky behavior that leads to HIV infection, to take care of orphans within their extended families, and to provide HIV/AIDS prevention and awareness education.

Microfinance practitioners have figured it out. We have cracked the code. We now know how to do this. And the question again is, do we want to invest in success and finish the job? Sixty percent of Opportunity's funding comes from private sources, private donors, and because of the quality and financial sustainability of our programs, we are very successful in accessing social investment capital and other sources of funds. Yet we need USAID moving forward. International and national commercial banks that operate on the basis of a single bottom line are unlikely to sustain commitments to the poor, and this has been shown. Quite simply, capital has no courage.

USAID has, in fact, been a major and valued partner of Opportunity International. Over the past 12 years the Agency has provided over $70 million in funding to Opportunity, creating market leaders in countries such as Ghana, Nicaragua, Russia, Montenegro and others. And the results, looking only at those countries where USAID has been our partner, a $70 million investment by the American people has leveraged a loan portfolio that today is over

$95 million, with rotating loans of $177 million provided in just the past year.

Despite this track record of success, Opportunity is one of a number of industry leaders that is receiving diminishing funds from USAID. An informal survey of the members of the Microenterprise Coalition in 2004 showed that several world-class organizations, ACCION, FINCA, Freedom from Hunger, Pro Mujer, Save the Children, and WOCCU showed serious declines in funding from USAID over the previous 2 years, and prospects for the future looked grim.

A few of us were holding steady: World Vision, Catholic Relief Services, and Opportunity International, although Opportunity's numbers were strong primarily because of a single $10 million award for Serbia.

So the question for us is, why is USAID abandoning rather than investing in its successful not-for profit partners? A related question is, do you believe it is important to provide services directly to the poor, which means retail microfinance? In many of the countries where we work, including in Africa, we have been told by USAID that there are simply no discretionary economic development funds available, including for microfinance. And where such funds do exist, we are often excluded from competing because the awards are given through contracts rather than through grant or cooperative agreements. With our experience and long-term commitment, we are baffled that we are unable even to compete for USAID funds in countries such as Mexico, Nigeria, Honduras, and Rwanda, countries where all told we have pledged to bring to the table over $15 million in private funds. Will you level the playing field so that organizations such as Opportunity, with deep experience, private funding to match, and skin in the game can compete fairly for funds?

The Microenterprise Results and Accountability Act of 2004 was intended to address just these kinds of issues. To our view as practitioners, it looks as if a big ship is taking a very long time to turn. Nine months after the passage of the legislation, our partners in the field have not reported any change in the kinds of mechanisms or task orders used by the USAID missions.

We are delighted that the IGP, the Implementation Grant Program, is going to be reinstated, although disappointed that is not until 2006. And we do laud the creation of the Leader With Associates FIELD-Support mechanism, an excellent mechanism. But that is one award that annually will be $2 million from the central Office of Microenterprise Development, and that hardly is sufficient to fill the bill, out of an appropriation of $200 million, of emphasizing the use of not-for-profit implementing partners, according to the law. That represents 1 percent of USAID's total funding for microfinance and microenterprise and 10 percent of the total budget for the Office of Microenterprise Development. It remains unclear to us, despite the LWA mechanism, how USAID will assist with providing targeted core support for microfinance and microenterprise networks as specified in the law.

And, above all, there is the issue of retail microfinance institutions that work directly with the poor. Enabling environment and other infrastructure and policy initiatives are worthwhile, but it

simply is folly to fund everything except a place where a poor person can get a loan or deposit their savings.

Microfinance is well known as an effective means of reaching and empowering poor women, and one of those empowered women is Gertrude Ssebunya. She lives in Uganda, where she is caring for 14 AIDS orphans in addition to her own 3 children. The loan training and support that she receives through her Opportunity Trust Bank lending group have helped her to build a small pharmacy business that allows her to pay school fees, buy uniforms and build a future for her family.

Gertrude said, "We are not afraid to work hard and to watch out for our children." Gertrude and her sisters around the world are ready to work, they are ready to build a life of self-reliance. Are we ready to help them? Let us invest in a program that transforms lives, and let us finish the job.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Cheston follows:]

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

Good afternoon. I am very grateful for the opportunity to testify today. Chairman Smith, on behalf of Opportunity International and the Microenterprise Coalition, I would like to express our gratitude to you and to the other members of the subcommittee for your important leadership on microfinance on behalf of the poor.

When I was working as a loan officer to poor women in El Salvador in the early 1990's, I never dreamed that by 2003, the Microcredit Summit Campaign would report that over eighty million poor people were working toward self-reliance with the help of microloans—quite a phenomenal number considering that formalized microfinance as we know it only began some three or four decades ago. This is extraordinary success-and now that we have figured out our systems and methodologies, we are poised to reach millions more clients who do not have access to basic financial services and who can transform their lives once they receive them. The results are worth fighting for: increased income resulting in more girl and boy children in school, better housing, more money to pay for health care, a decrease in domestic violence, and the means to care for orphans.

Do you want to let microfinance stagnate now, or do you want to invest in success and finish the job?

When I started working with the Women's Opportunity Fund of Opportunity International in 1992, we were giving out 6000 loans. In the past five years alone, Opportunity has grown by 460% and now has 770,000 loan clients while achieving 2% arrears and full sustainability, reaching 87% women, and providing an average initial loan size, outside Europe, of US$80. We have also provided insurance products to almost two million poor people. By 2010 we expect to be reaching two million loan clients alone, and many more clients with savings and microinsurance, as well as training in business skills, leadership development, HIV/AIDS, and many other areas.

During the next ten years, Opportunity plans to open 20 to 25 new banks for the poor in order to finance 12.6 million micro-businesses. Our focus for major expansion is Africa, and particularly those countries with a high incidence of HIV/AIDS. Over the next ten years, we plan to build commercial microfinance institutions in 16 African countries, financing 2.8 million micro and small businesses, thus empowering millions of poor women to avoid risky behavior, enabling extended families to care for their orphans, and providing HIV/AIDS prevention and awareness education to those who are most vulnerable to infection.

Opportunity and our sister organizations are ready-ready to stretch, with the help of our private donors and volunteer leadership, to meet the needs of millions of poor families who have no access to financial services, and for whom a microbusiness loan or a safe place to save their money can be life-transforming. Is Congress ready? Is USAID ready? Do you want to throw in the towel, or do you want to invest in success and finish the job?

For years, USAID has been a global leader in microfinance and, in many ways, has been a key driver in bringing capitalism at its best from the American people into some of the most neglected communities on the earth. A vital part of its strat-

egy has been the development of market leaders-including retail microfinance institutions built by organizations such as Opportunity International that provide poor people with direct access to financial services.

Microfinance practitioners have figured it out, we've cracked the code, we now know how to ramp up to reach many more poor families. We are part of a financial sector revolution that is ready to soar. Do you want to let microfinance stagnate now, or do you want to invest in success and finish the job?

Sixty percent of Opportunity's funding comes from private donations. Here with me today are several of our volunteer board members and donors. They are among the over 2000 Americans who, in 2004 alone, generously provided US$16.6 million in donations, in amounts ranging from two dollars to one million dollars. As well, because of the quality and financial sustainability of our microfinance institutions, Opportunity has been very successful in accessing social investment funds and other capital.

Yet we need USAID moving forward. International and national commercial banks that operate on the basis of a single bottom line are unlikely to sustain commitments to the poor. Quite simply, "capital has no courage."

Opportunity International, on the other hand, measures our success according to a triple bottom line: first, outreach to as many of the poorest people we can reach; second, sustainability; and third and most important, holistic transformation, or client impact.

USAID has, in fact, been a major and valued partner of Opportunity International. Over the past 12 years, USAID has provided over $70 million in funding to Opportunity International, creating market leaders in such countries as Ghana, Nicaragua, Russia, Serbia, and Montenegro. The results? A $70 million investment by the American people has leveraged a loan portfolio that today is over $95 million, providing $177 million in rotating loans to poor entrepreneurs in just the last year.

I would call that an excellent return on investment. And as an organization founded on business principles, I would suggest that when you have an excellent return and a successful partnership, you build on it.

Organizations such as Opportunity International are an interesting hybrid. We have the heart of a not-for-profit with a social mission, but we have the mind and muscle of a for-profit business. I count among my valued colleagues many talented and dedicated consultants-but for-profit consulting firms simply do not have "skin in the game." Opportunity creates banks for the poor-a place where poor people can get services. We fund their startup costs; we manage them; we innovate in products, services, and systems. We hire and fire CEOs; we serve on their boards. We raise grant, equity and debt financing for them. We create economies of scale for them through MIS hardware and software and through professional development of senior management across the globe. We have "skin in the game" in terms of equity and debt—and in terms of brand reputation.

Despite this track record of success, Opportunity is one of a number of industry leaders that is receiving diminishing funds from USAID. An informal survey of members of the Microenterprise Coalition in May 2004 showed that several world class organizations—ACCION, FINCA, Freedom from Hunger, ProMujer, Save the Children, and WOCCU—had shown serious declines in their funding from USAID over the previous two years, and that prospects for the future looked grim. World Vision was holding steady, along with Catholic Relief Services and Opportunity International-and Opportunity's numbers were strong in the short term only because of a single $10 million grant for Serbia.

Do you believe it's important to have retail microfinance—a place, even someplace as nontraditional as an off-road vehicle, where poor people can go to get a loan or deposit their savings? If so, do you want to invest in successful not-for-profit partners, or do you want to abandon them? Do you want to finish the job?

In many of the countries where we seek to work, including in Africa, we have been told by USAID that there are simply no discretionary economic development funds available, including for microfinance. And where such funds do exist, we are often excluded from competing because the awards are given through contracts rather than through grants or cooperative agreements. With our experience and long-term commitment, we are baffled that we are unable even to compete for USAID funds in countries such as Mexico, Nigeria, Honduras, and Rwanda-countries where, all told, we have pledged to bring to the table over $15 million in private funds.

Will you level the playing field so that organizations with years of experience, private funding to match, and "skin in the game," can compete fairly for funds?

The Microenterprise Results and Accountability Act of 2004 was intended to address just these kinds of issues. And has it? We recognize that a big ship takes a long time to turn, but we are nevertheless surprised that, nine months after the passage of the legislation, our partners in the field have not reported any change

in the kinds of mechanisms or task orders used by the USAID missions. The USAID Office of Microenterprise Development (OMD) did report in February that they will reinstate the valued Implementing Grant Program, or IGP-but not until 2006.

The major effort in compliance from OMD appears to be the creation of a Leader With Associates (LWA) funding mechanism called FIELD-Support. It's a good mechanism and the effort is very much to be lauded-but one $2 million annual award out of an appropriation of $200 million is hardly adequate to fill the bill of "emphasizing" the use of not-for-profit implementing partners, according to the law. We understand "emphasize" to imply well over fifty percent, whereas the LWA represents one percent of total USAID funding for microfinance, and ten percent of the total budget for the Office of Microenterprise Development-and other mechanisms that we're aware of are helpful but do not make up the difference. It also remains unclear to the Microenterprise Coalition how the FIELD-Support LWA or any other mechanism announced to date will assist with providing "targeted core support for microfinance and microenterprise networks and other practitioners," as specified in the law.

Nor does the LWA emphasize support for building retail microfinance institutions that work directly with the poor. Enabling environment and other infrastructure and policy initiatives are worthwhile-but it is simply folly to fund everything except a place where a poor person can get a loan.

USAID has done some groundbreaking work recently in reaching poor women with microfinance, most notably in the Middle East, where their encouragement of poverty-focused group loans resulted in dramatic increases in outreach to women. Yet there is much yet to be done to ensure that microfinance realizes its potential to empower poor women, as many women remain unserved or underserved.

Finally, Opportunity International, through our Lending Hope to Africa campaign, has made a $25 million commitment to fight HIV/AIDS. USAID helped us to secure a major award from the Office of the Global AIDS Coordinator (OGAC) in the first tranche of the President's Emergency Plan for AIDS Relief (PEPFAR), which has been enormously important in enabling us to use our extensive infrastructure of Trust Bank lending groups in the fight against AIDS. Yet since that first tranche, to our knowledge no other microfinance network has received an award from OGAC's central office.

One of Opportunity's clients in Uganda is Gertrude Ssebunya, who is caring for 14 AIDS orphans in addition to her own three children. The loan, training and support she receives through her Trust Bank lending group have helped her to build a small pharmacy business that allows her to pay school fees, buy uniforms and build a future for her family.

Gertrude and her sisters around the world are ready to work. They are ready to build a life of self-reliance. Are we ready to help them?

Let's invest in a program that transforms lives. Let's finish the job.

Thank you.

Mr. SMITH OF NEW JERSEY. Thank you so very much for your testimony and for your excellent work.

Mr. Plank.

STATEMENT OF MR. GARY PLANK, PRESIDENT–ELECT, WORLD COUNCIL OF CREDIT UNIONS

Mr. PLANK. Chairman Smith, Ranking Member Payne, Members of the Subcommittee, on behalf of the Credit Union National Association and the World Council of Credit Unions, I appreciate this opportunity to express our views of how international credit union development is impacted by the Microenterprise Results and Accountability Act of 2004.

As has been stated, I am Gary Plank, President and CEO of the Arizona Credit Union League, Chairman of the World Council of Credit Unions, and Chairman of the CUNA's World Leadership Development Committee.

CUNA is the largest credit union organization in the United States, serving over 90 percent of our Nation's 9,000 credit unions and their 87 million members. The World Council represents the

interests of credit unions in 91 countries and is an international trade association and development agency for credit unions.

As a partner with the U.S. Agency for International Development, the World Council has been implementing programs in the microfinance field for over 35 years. Credit unions are people helping people. They are not-for-profit; democratically controlled, owned and managed by people they serve. Credit unions in developing countries regularly make loans under $500 to help members build their businesses and improve their families' lives.

World Council programs improve credit union performance so that these financially sustainable institutions can offer a full range of services to members. Our approach to microfinance focuses on the mobilization of savings to create access to affordable financial services. World Council is carrying out 15 multiyear programs, 9 of which are funded by USAID. The credit unions supported by these programs serve 3.1 million member clients and have mobilized $3.9 billion in savings to fund over $3.6 billion in loans.

We have a strong partnership with USAID's Microenterprise Development Office, from which we have won seven competitive cooperative agreement awards. Despite our strong track record with both central and mission funding, new project funding has been drastically affected by USAID's trend to procure microenterprise work through contracts instead of cooperative agreements.

USAID now funds broad umbrella programs to work across the financial sector with general training provided by contractors instead of funding specialized programs with expertise provided by practitioners. The breadth of the activities bundled into a large contract requires economies of scope from contractors, precluding small firms from being able to viably compete.

The opportunities to compete for cooperative agreements have decreased substantially while contractors do not have any incentive to meaningfully subcontract with specialized non-profit organizations. A for-profit firm has, as its core mission, to maximize profits; therefore, it has no incentive to include us.

We feel more poor people would be reached cost-effectively by USAID investing in cooperative agreements. For example, in the Philippines we implemented two programs totaling $7.2 million, reaching over 419,000 clients by project end. By comparison, in the Philippines during a similar time frame, a USAID contractor implemented a $12 million contract reaching 257,000 clients. In short, it costs $17 per client with our programs compared to $47 per client with a contractor's program.

CUNA and the World Council implore Congress to recognize that fundamental changes must be made in USAID procurement practices and staffing levels to reverse this trend of issuing large contracts.

An additional incentive to use cooperative agreements is the U.S. credit union movement's direct involvement in many of the World Council's projects through an international partnership program. There are 18 partnerships between State credit union leagues and the credit union movements in developing countries. Many of these partnerships stem from our programs that are funded through cooperative agreements. Arizona credit unions are partnered with Caja Libertad, Mexico's second largest credit union.

It is clear to me that if USAID funding trends continue, USAID loses the additional leverage benefit of the U.S. credit union movement's volunteer service to enhance our projects.

In closing, CUNA and the World Council implore Congress to: (1) ensure the effectiveness of microenterprise programs by enforcing central funding for the Microenterprise Development Office; (2) provide adequate funding for USAID technical and acquisition personnel so that large umbrella contracts are not necessary; and (3) continue to encourage USAID to use instruments for which specialized practitioners can compete.

We are optimistic that if implemented as Congress intended, the Microenterprise and Results Accountability Act of 2004 can propel more productive microenterprise development and ensure continued success for one of USAID's most important development assistance tools.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Plank follows:]

PREPARED STATEMENT OF MR. GARY PLANK, PRESIDENT-ELECT, WORLD COUNCIL OF CREDIT UNIONS

Chairman Smith, Ranking Member Payne and members of the Subcommittee, on behalf of the Credit Union National Association (CUNA) and the World Council of Credit Unions (WOCCU), I appreciate this opportunity to come before you today to express our organizations' views on how international credit union development and microenterprise programs are impacted by the implementation of the *Microenterprise Results and Accountability Act of 2004.*

CUNA is the largest credit union advocacy organization in the US, representing over 90% of our nation's approximately 9,000 state and federal credit unions and their 87 million members. CUNA is also the largest member of WOCCU, the international trade association and development agency for credit unions. WOCCU represents the interests of credit unions in 91 countries, totaling over 43,000 credit unions and 136 million credit union members. WOCCU has been implementing technical assistance programs in the microenterprise field for over 35 years, and is committed to assisting in the continued growth and progress of credit unions around the world.

I am Gary Plank, President & CEO of the Arizona Credit Union League, and Chairman of WOCCU. The Arizona Credit Union League represents over 60 credit unions throughout the state and actively works with Caja Libertad, Mexico's second-largest credit union, through WOCCU's International Partnership Program. I also serve as Chairman of CUNA's World Leadership Development Committee.

CUNA and WOCCU are pleased that the Subcommittee is reviewing the implementation of the microenterprise bill which addresses development project funding at the mission and central office levels of the US Agency for International Development (USAID). I am pleased to have the opportunity to speak to the distinctive credit union approach to microfinance, how WOCCU has worked in partnership with the USAID to provide access to an array of affordable financial services to the poor in developing countries, how USAID's recent trend in issuing large contracts has impacted WOCCU's ability to implement new projects, and the role of US credit unions in supporting international credit union development.

THE CREDIT UNION APPROACH TO MICROFINANCE

In the US and around the world, credit unions are in the business of helping people help themselves to improve their lives. As not-for-profit democratically controlled financial cooperatives, credit unions are owned and managed by the people they serve. They mobilize savings from within their communities so they can make loans to members who need them. In the same way that struggling Americans have been coming together to form credit unions with the philosophy of self-help since the 1930s, credit unions overseas afford poor and low-income people the opportunity to accumulate assets and take a step up the rung of the ladder from poverty to wealth.

WOCCU technical assistance programs improve credit union performance so that these financially sustainable institutions can offer services to members of all wealth levels. The strategies that WOCCU-affiliated credit unions implement to mainstream services and scale up to integrate mass numbers of poor people into the fi-

nancial sector include: offering an array of client-responsive services; extending geographical coverage; introducing distinct products for downreach; and harnessing technology. WOCCU's development efforts focus on the micro—establishing and/or strengthening credit unions, meso—creating and/or professionalizing second-tier credit union organizations, and macro—improving the regulatory environment for credit union operations.

WOCCU pioneered the "Model Credit Union Building" methodology that includes a strong emphasis on savings mobilization and financial disciplines. Like clients from other wealth levels, the poor need an array of financial services in order to employ economic coping strategies. WOCCU services, tailored to clients of diverse wealth levels, include innovative savings, lending and insurance products as well as transaction services such as affordable money transfers, shared branching and debit cards.

To reinforce prudential standards, institutional stability and ensure real positive growth, WOCCU monitors credit union performance through its PEARLS financial performance monitoring system. WOCCU transfers its PEARLS and business planning tools to participating credit unions, members and regulators to provide its users management and supervisory guidance.

Though the focus of WOCCU's projects range from savings to remittances and insurance, microenterprise lending is always a key component to helping individuals and communities achieve financial security and independence. As a significant source of microenterprise funding, credit unions have helped thousands of women and men in the developing world start small businesses and learn important skills for self-support. Credit unions in developing countries regularly make loans under $500 to help struggling self-employed members build their businesses and improve their families' lives. The following story illustrates an example of the tremendous impact of credit union microfinance services abroad:

After the death of her two brothers from AIDS, Roseline Wangawi, a home economics teacher and credit union member in Kenya, took on the responsibility of providing for her brothers' five orphaned children in addition to her own four. Needing to supplement her income, she decided to sew and embroider during the weekends and holidays. She borrowed $400 from her credit union to buy an embroidery machine. With a growing business, she has been able to pay off that loan, support her family, pay school fees and accumulate savings at the credit union.

The credit union approach to microfinance focuses on access to affordable financial services, and providing people with the financial literacy skills and tools to improve their lives. WOCCU's project credit unions have proven to be successful vehicles for the provision of microenteprise loans to individuals who go on to start their own businesses, employ others in the community and accumulate assets.

WOCCU IN PARTNERSHIP WITH USAID

WOCCU, funded by USAID and other bilateral and multilateral agencies, also receives contributions from US credit unions through CUNA, CUNA Mutual and the National Credit Union Foundation (NCUF). WOCCU is currently carrying out 15 multi-year country programs, nine of which are funded by USAID. The credit unions supported by all of these programs serve 3.1 million member-clients and have mobilized $3.9 billion in deposits to fund the portfolio of member borrowing needs of $3.6 billion.

WOCCU has been a longstanding implementing partner of USAID. In particular, WOCCU has had a strong partnership with the Office of Microenterprise Development from which it has won seven competitive Innovative Grant Program (IGP) cooperative agreement awards amounting to $16 million from 1995–2003 for life-changing credit union strengthening programs in Ecuador, Kenya, Philippines, Romania, Vietnam, Mexico and Colombia.

One example of an IGP program that illustrates the effectiveness of this type of cooperative agreement is WOCCU's Caja Popular Mexicana program. During the four-year (2001–2005), $3.5 million program, WOCCU has worked to strengthen Mexico's largest credit union to more than double its outreach from 477,000 to more than one million member-clients; to develop financial products to better serve the needs of microentrepreneurs; and to distribute remittances to financially struggling members and non-members through more than 300 branches throughout rural and urban parts of the country.

WOCCU recognizes the value of the central Microenterprise Development office. This office, staffed with technical experts in microfinance and business development services, has experimented, developed and forged the frontier of new and more effective ways to deliver financial services to the poor and unbanked. Many of these in-

novative services and expanded accessibility to the poor have been through credit unions through IGP awards.

In addition to implementing centrally funded microenterprise development programs, WOCCU has partnered with a numerous USAID missions to implement microenterprise development programs. As a specialized implementing partner, WOCCU strongly believes in the value of the consultation by the Office of Microenterprise Development staff with the staff of USAID mission offices to ensure the design and procurement of best practice microenterprise programs.

An investment of US foreign assistance in credit union development produces sustainable, savings-driven institutions that continue to serve their members long after US contributions are made. USAID-funded credit union projects through WOCCU have resulted in sustainable financial institutions that have changed economies throughout communities in the developing world.

USAID TRENDS TO LARGE CONTRACTS

For 35 years as a USAID implementing partner, WOCCU has worked on the ground delivering specialized training to create new credit unions, reforming and modernizing credit unions, and improving the regulatory and supervisory framework for credit unions. Despite our strong track record, WOCCU has been drastically affected by USAID's trend to procure financial services and microenterprise work through large contracts implemented by for-profit contractors rather than competing work through cooperative agreements and grants. USAID now funds vast umbrella programs that attempt to work across the financial sector with general training provided by contractors and their consultants instead of funding specialized programs with expertise provided by specialized practitioners. The breadth of the activities bundled into one large contract require economies of scope from the competing contractors, essentially precluding small specialized firms from being able to viably compete as prime implementers for large contracts.

The opportunities to compete for cooperative agreements have decreased substantially while, alternatively, prime contractors do not have any incentive to meaningfully subcontract with specialized non-profit organizations. A for-profit firm has as its core mission to maximize profits; therefore, it has the incentive to minimize subcontractor participation.

As evidence, between 1994 and 2002, WOCCU's average historical annual volume of authorized project start-ups was $8 million. In 2003, WOCCU won new USAID awards for only $3.5 million. In 2004, WOCCU fared only slightly better with new awards totally $4.8 million.

It has been WOCCU's experience at multiple USAID missions in places as diverse as Uganda and Sri Lanka that mission staff interested in credit union development direct WOCCU to petition large contractors in order to secure opportunities to work in mission territory rather than issuing a competition for a separate award or considering an unsolicited proposal. This trend of relegating programmatic decisions to the prime contractor results in a loss of control by USAID and a loss in quality delivery of capacity-building services to credit unions in the field.

USAID contracts have become increasingly large and are now encompassing sectors as diverse as alternative development, agribusiness, small and medium enterprise, thereby relegating financial services to essentially a support role in the scope of work. We recognize the ease for USAID, constrained by limits on the number of contracting and technical personnel, to have one large contract than to make several smaller individual awards. Individual awards for specialized sectors such as microenterprise for which niche practitioners can compete require not only more procurement personnel, but also additional technical staff to effectively design and manage programs that follow best practices for microfinance.

CUNA and WOCCU implore Congress to recognize the fundamental changes that must be made in USAID procurement practices and capacity to reverse the trend of issuing large contracts and impeding the ability of smaller, not-for-profit firms to compete for funding. WOCCU submits, in fact, that though they may be easier to procure, large contracts provide questionable value for the investment.

Example of WOCCU IGP Project versus Contractor Project

WOCCU has worked in the Philippines for eight years. USAID's Office of Microenterprise Development first funded WOCCU's work for five years with an IGP award of $3.7 million from 1996–2002 and the Manila mission funded WOCCU for a subsequent three years for $3.5 million. A total USAID investment of $7.2 million through two cooperative agreements yielded more than 30 credit unions serving 419,500 member-clients, 73% of whom are women as of June 2005. The average loan size is $282; the average deposit size is $102. Savings and shares fully fund the loan portfolio.

For a similar time period, 1998–2004, USAID contracted with a leading contractor for $12 million dollars for a microfinance program in the Philippines. The external evaluation of this project reports that there were 45,216 borrowers and 188,669 microdepositors as of December 2003, nine months before the project closed. The final project targets were 57,000 microborrowers and 200,000 microdepositors; therefore, the project presumably achieved its targets. The average loan size was $127.

It is a difficult and complex task to compare apples to apples when looking at contracts versus cooperative agreements and umbrella projects versus specialized projects. However, I want to leave with you this investment versus outreach summary: $7.2 million and 419,500 credit union member-clients after eight years compared to $12 million and a targeted 257,000 clients after seven years. The more cost-effective investment of U.S. taxpayer dollars in this example is clear: $17 per client with WOCCU's Philippines programs and $47 per client with the contractor's program.

	Funding	Clients	Cost per Client
WOCCU Philippines	$7.2 million	419,500	$17
Contractor	$12 million	257,000	$47

It is CUNA and WOCCU's position that the Subcommittee should compel USAID to include cooperative agreements in its mix of procurement instruments so as not to preclude specialized practitioners from competing to design and deliver the services that they provide best. WOCCU has far greater capabilities of reaching large numbers of the underserved.

THE ROLE OF THE U.S. CREDIT UNION MOVEMENT

The US credit union movement is directly engaged in international credit union development through WOCCU's International Partnership Program. In Arizona, credit unions are actively participating in our partnership with Mexico's second-largest credit union. The partnership reinvigorates the commitment of both parties to the credit union philosophy of people helping people. Our partner, Caja Libertad, has provided us with advice on how to market to the underserved Hispanic community in Arizona. In turn, we have motivated Caja Libertad to open new offices in remote rural areas of Mexico which have never before been served by any type of formal financial institution.

There are 18 such partnerships between state credit union leagues and credit union movements in developing countries. Most of these partnerships stemmed from a WOCCU program funded through a USAID cooperative agreement, and continue with the financial and personal support of the involved US credit unions, leagues and their staffs. WOCCU provides the initial coordination and guidance so that US credit union professionals can volunteer their time to contribute technical expertise to further program objectives and foster cross-border relationships which last long after the USAID project is complete.

From my vantage point as a US credit union leader, it is clear to me that as the use of large contracts increase, the US credit union movement loses opportunities to contribute volunteer service advancing hands-on foreign assistance and developing an understanding of the world outside US borders.

CONCLUSION

The recent tender of the microenterprise FIELD-Support "Leader with Associates" (LWA) procurement mechanism for not-for-profit consortiums by the Microenterprise Development office, made possible by the resources authorized by the *Microenterprise Results and Accountability Act of 2004*, is one response to decreasing opportunities for small, specialized non-governmental organizations to compete for development funding. A launch of a new IGP competitive round to be awarded in 2006 after two years without IGP competitions is another response.

CUNA and WOCCU applaud these first responses; however, they need to be the first steps of many to follow to address the disturbing trend by USAID to issue large, pre-competed contracts and massive multisectoral umbrella contracts. A next vital step is for USAID personnel levels to be increased so that cooperative agreements are tendered by missions to engage specialized practitioners to ensure that "US Aid from the American People" benefits the greatest number of underserved people with access to sustainable financial services.

CUNA and WOCCU implore Congress to:

- Ensure the efficiency and effectiveness of microenterprise programs by enforcing the central funding of the Microenterprise Development office as set forth in the Microenterprise Results and Accountability Act of 2004;
- Provide adequate funding for USAID technical and acquisition personnel so that large umbrella contracts are not necessary for administrative ease; and
- Continue to encourage USAID to use procurement instruments for which specialized not-for-profit practitioners can compete, and emphasize the value of direct service providers on the ground implementing long-term sustainable development projects rather than more limited grants under umbrella contracts.

CUNA and WOCCU are optimistic that if implemented as Congress intended, the *Microenterprise and Results Accountability Act of 2004* can propel more productive microenterprise development and ensure the continued success of one of USAID's most important development assistance tools. Thank you for holding this important hearing and I look forward to a continued dialogue on maximizing the US foreign assistance investment through fair and effective microenterprise programs.

Mr. SMITH OF NEW JERSEY. Thank you very much for your leadership as well.

I would like to now ask Mr. Yanovitch to proceed.

STATEMENT OF MR. LAWRENCE YANOVITCH, DIRECTOR OF POLICY AND TECHNICAL ASSISTANCE, THE FOUNDATION FOR INTERNATIONAL COMMUNITY ASSISTANCE

Mr. YANOVITCH. Good afternoon.

I also would like to make summary remarks, Mr. Chairman. I would like to thank you, Chairman Smith, for having me here today and for your exceptional leadership in microfinance. I would also like to thank the Members of the Committee for allowing me to share my views along with Assistant Administrator Jay Smith. I traveled with Mr. Smith, as he mentioned, to Ecuador this summer with staff from the Committee and FINCA's Ambassador of Hope, Natalie Portman.

It is my personal view that Mr. Smith is a development professional with great integrity who is clearly committed to moving microfinance forward inside of USAID, and I got a very strong impression of him when I was traveling. However, change is difficult for all organizations, and the perspectives I share with you today are offered in the hope of realizing the potential that microfinance has for achieving U.S. foreign assistance goals.

We are here to discuss accountability, and microfinance is all about accountability. Clients receive loans, not grants, and are responsible for their timely repayment.

Since this hearing focuses on the implementation of the Microenterprise Results and Accountability Act, I would like to speak to two key objectives underpinning that legislation: (1) has USAID implemented the prescriptions in the law so that more taxpayer dollars flow into the hands of those institutions that directly provide services to the poor?; and (2) is USAID leveraging microfinance to open up financial sectors in developing countries so that large numbers of the poor have access to investment capital with which they can break out of poverty?

It is in the best interest of the United States—our people and our Government—to foster what I would call a multi-tiered financial sector in developing countries, a financial sector with an array of

financial service providers giving business loans to different market segments, including the very poor.

For example, last month I traveled to Afghanistan to visit our program there that I manage. There, microfinance is not only building a financial sector—in a country where a stable banking environment has been almost nonexistent—but building the capacity of both men and particularly women to become active members of a representative society.

In addition to the many microfinance clients who are now teeming into FINCA's market offices for loans in places like Herat on the Iranian border and the capital city of Kabul, I also had the opportunity to meet with members of the Afghan cabinet to help illustrate the enormous impact microfinance can have on the financial sector as a whole. I shared with them the example of Uganda and the growth of the microfinance sector there.

Microloans in Uganda are helping people like Mrs. Efuwa, a FINCA client. When I met her in 2004, she had successfully paid off her first microloan of $100. Before the loan, she was making less than 15 cents a day as a field laborer. She had 11 children, 6 of whom were HIV/AIDS orphans. With her loan, Mrs. Efuwa opened an outdoor cooking stall near a factory. She now makes more than $1 a day, and her first priority is to buy beds for the family.

In recent years, funding garnered from USAID for FINCA programs has greatly diminished, as we have heard from some of the other witnesses today. In fiscal year 2002, FINCA funding from USAID stood at nearly $3.6 million. This same number dropped to nearly $2 million in 2004 and to less than $270,000 in 2005, an 87 percent decline for the year.

I will just venture from my prepared text for a moment to mention Ecuador, the country that I visited with Mr. Smith. He discussed the umbrella project there managed by a contractor and suggested that this was helpful because it helped to develop the policy environment. When we went to that umbrella contractor asking for resources for FINCA, they really didn't have any for us. We ultimately had to go to USDA to capitalize the program; and the contractors told us, until we were a regulated institution, until we were a commercial bank, until we were a financial company, we would not qualify. Now they are indeed helping us, but it is a little late in the game.

So while funding to providers such as FINCA was on the decline, U.S. funding appropriated by Congress for the Office of Microenterprise Development and microenterprise activities in general has been increased. This funding is primarily channeled through USAID missions. There is little evidence at the missions that the staff are knowledgeable about the law governing USAID's microenterprise program; and, as a result, they often outsource the formulation and execution of microfinance strategy to consultants. In the process, the resources that ultimately get into the hands of the poor are diminished.

For instance, just earlier this year, the USAID mission in Azerbaijan had planned to focus on direct service providers, but then suddenly, without warning, the mission switched to a consultant-led enabling environment initiative.

I want to note that consultants are essential for the development of microfinance. For instance, DAI has done an excellent job serving in the supporting role in the microfinance investment facility in Afghanistan. As in a good play, consultants need to be properly cast. USAID now tends to cast them in the leading roles, as opposed to supporting roles, and herein lies the mistake.

In the past, the Office of Microenterprise Development played to the comparative strengths of all the players in the field to yield the best outcomes. There was a strong focus on building solid retail microfinance institutions. This focus seems to have been skewed disproportionately toward the academic issues of microfinance and away from the grassroots.

Without continued investment in these grassroots entities, microfinance cannot reach its promise. Just to keep up with the population growth in the Middle East, there will need to be roughly 4 million new jobs created every year for the next 20 years, an issue that I have been working on through FINCA with Her Majesty Queen Rania.

Can a microfinance strategy that focuses too broadly on enabling environments and technical assistance really be called upon to meet the needs of the Middle East? Can an enabling environment contribute on a broad scale to the empowerment of women in Afghanistan? I would argue that a strategy that encompasses both growth in direct service providers and strong enabling environments positions the United States once again as a leading-edge promoter of overall best practice microfinance. The opportunity is there for the U.S. and partner organizations to nurture the seeds of microfinance so that with respect, responsibility, and accountability these individuals, these communities, and these countries can do more for themselves than we can ever do for them.

In short, my recommendations for the implementation of the Act are the following: (1) each USAID mission should name a point person to lead the implementation of the legislation at the mission level; (2) the Office of Microenterprise Development should fulfill section 252 of the law and establish a program to provide targeted core support for implementing partner organizations that provide direct services to the poor; and (3) as prescribed in the Microenterprise for Self-Reliance Act, the U.S. Treasury should actively participate with USAID in opening financial sectors to the poor.

It is absolutely essential that we as a Nation do not miss the opportunity to truly harness the full potential of microfinance on a global scale, a potential that can only be reached by funding those who are providing services directly to the poor.

Thank you.

[The prepared statement of Mr. Yanovitch follows:]

PREPARED STATEMENT OF MR. LAWRENCE YANOVITCH, DIRECTOR OF POLICY AND TECHNICAL ASSISTANCE, THE FOUNDATION FOR INTERNATIONAL COMMUNITY ASSISTANCE

Good afternoon. First, I would like to thank Chairman Smith, for having me here today and for his continued support of microfinance as a development tool. I would also like to thank the members of the committee for allowing me to share my views along with Assistant Administrator Jay Smith. I traveled with Mr. Smith to Ecuador this summer with staff from the Committee and FINCA's Ambassador of Hope, actress Natalie Portman.

It is my personal view that Jay Smith is a development professional with great integrity who is clearly committed to moving microfinance forward inside of USAID. However, change is difficult for all organizations and the perspectives I share with you today are offered in the hope of realizing the potential that microfinance has for achieving US foreign assistance goals.

We are here to discuss accountability, and microfinance is all about accountability. Clients receive loans, not grants and are responsible for their timely repayment.

Since this hearing focuses on the implementation of the Microenterprise Results and Accountability Act of 2004, I would like to speak to two key objectives underpinning the legislation:

- Has USAID implemented the prescriptions in the legislation so that more taxpayer dollars flow into the hands of those institutions that directly provide services to the poor.
- Is USAID leveraging microfinance to open up financial sectors in developing countries so that large numbers of the poor have access to investment capital with which they can break out of poverty?

I would imagine that virtually every person you will hear from today can attest to the power and the potential of microfinance. Historically, microfinance is one of the most effective and proven development vehicles for tapping the business and leadership potential of the poorest members of society and in the process, fostering more equitable and pluralistic societies.

The American people through Congress and their own pocket books via donations to organizations such as FINCA, World Vision, Save the Children and Opportunity International have endorsed microfinance—delivered through direct retail service providers—as a strategy they support to help alleviate poverty.

It is in the best interest of the United States—our people and our government—to:

- Facilitate access to financial services,
- Nurture microenterprise in developing countries; and
- Build inclusive financial sectors.

By supplying these lending opportunities to those in the most need, microfinance helps stop extremism and hatred before they erupt into global conflicts and terrorist activities. Successful microfinance clients have the tools needed to participate in a democratic society and more importantly they have hope for the future, a crucial commodity in any society.

For example, last month I traveled to visit our offices in Afghanistan. There microfinance is not only building a financial sector—in a country where a stable banking environment has been almost non-existent—but building the capacity of both men and particularly women to become active members of a representative society.

In addition to the many microfinance clients who are now teaming into our market offices for loans in places like Herat and Kabul, I also had the opportunity to meet with members of the Afghan cabinet to help illustrate the enormous impact microfinance can have on the financial sector as a whole. I shared with them the example of Uganda and the growth of the microfinance sector there.

Micro loans in Uganda are going to people like Mrs. Efuwa a FINCA client. When I first met her in 2004, she had successfully paid off her first micro loan of $100. Before the loan she was making less than 15 cents a day as a field laborer; her husband less than 75 cents a day in construction. They had eleven children, six of whom were HIV/AIDS orphans. They lived in a small one room house. The only bedding they had was from the clothing of deceased relatives. With her loan, Mrs. Efuwa opened an outdoor cooking stall near a factory. She now makes more than $1 a day and her first priority is to buy beds for the family.

Policy makers often see this type of micro lending as a social safety net. Many are not convinced that clients like Mrs. Efuwa add any value to the economy. Nor do they consider that microfinance organizations that serve clients like Mrs. Efuwa have a transformational impact on the financial sector.

According to recent data, commercial banks in Uganda have more than 200,000 depositors and only 17,000 borrowers. In contrast, microfinance institutions are lending to more than 400,000 clients or 20 times as many borrowers as commercial banks.

To help garner the many financial and social benefits of microfinance, it is also in the best interest of the United States to utilize best-practice implementing orga-

nizations—be they for-profit, not-for-profit, local, or international—to ensure the delivery of effective, sustainable foreign assistance over the long term.

USAID's microenterprise program has flourished over the past 20 years and FINCA has flourished with it. In fact, FINCA was built in part through a matching grant from USAID's office of private voluntary cooperation. Also, the growth of one of our most successful affiliates, FINCA Ecuador was financed via a USAID PRIME grant of $600,000 in 1997 from the microenterprise office. Loans dispersed by this affiliate in Ecuador now stand at almost $35 million.

However, that $600,000—a relatively small number when considering foreign aid—received by our Ecuador program in 1997 is more than double that received by the entire FINCA network for FY 2005. In recent years funding garnered through USAID for FINCA programs has greatly diminished:

- For FY2002 FINCA funding from USAID stood at nearly $3.6 million.
- This same number dropped to nearly $2 million in FY2004 and to less than $270,000 ($267,788) in FY2005—an 87 percent decline for the year.
- During the same period, FINCA drew on other funding sources. Our network programs grew 40 percent and loans outstanding have increase from almost $33 million to more than $95 million.

And while funding to providers such as FINCA was on the decline, US funding appropriated by Congress for the Office of Microenterprise Development and microenterprise activities in general has been increased. The fact that FINCA can still survive in spite of decreased government funding illustrates the power of a global institution to leverage funding across a network to sustain stable institutions while it develops capacity in newer ventures.

Much like its clients, FINCA leverages invested capital from commercial sources such as the international responsAbility fund, a socially conscious investment group, to multiply their effect. This process not only garners additional millions in equity, but increases social impact in affiliates across the globe.

The small amounts of USAID funding—particularly crucial funding for loan capital and start-up operations that have been so critical in helping build sustainable microfinance institutions—are drying up. This type of funding is critical to expanding the reach of microfinance services to the estimated 800 million people as yet unserved in the microfinance market.

Given that microenterprise development appropriations are not earmarked, this essential funding often comes from USAID missions. Due to personnel cutbacks, these missions lack staff with technical knowledge of the intricacies of microfinance. They often outsource the formulation and execution of their microfinance strategy to consultants. In the process, the resources that finally get into the hands of the direct service providers are diminished. Moreover, the focus of these consultant-led initiatives tends to be on industry building activities instead of getting resources into direct service provision.

Since the enactment of the law, we have not seen any evidence that this pattern at the missions has changed. Indeed, USAID Azerbaijan had a strategy earlier this year where they planned to focus on direct service providers. The mission then suddenly switched to a consultant-led microfinance industry initiative. I want to note that consultants are essential for the development of microfinance. For instance, DAI has done an excellent job serving in a supporting role to the Microfinance Investment Support Facility for Afghanistan (MISFA). As in a good play, consultants need to be properly cast. USAID now tends to cast them in the leading roles as opposed to the supporting roles and herein lies the mistake.

At the central level, the Office of Microenterprise Development has not formulated a clear vision for implementing the prescribed changes called for in the Act. The Leader with Associates (LWA) mechanism does seek to work through direct service providers. It has been in formulation for more than a year now and has yet to be implemented. It also seems to focus more on industry building activities and not direct service provision. There is little evidence at the missions that staff are knowledgeable about the law governing USAID's microenterprise program.

In the past the Office of Microenterprise Development played to the comparative strengths of all players in the field to yield the best outcomes. There was a strong focus on building strong retail microfinance institutions. This focus seems to have changed to an "industry building" agenda and less on service providers.

Without continued investment in direct service providers, microfinance cannot reach its promise. Just to keep up with the population growth in the Middle East, there will need to be roughly 4 million new jobs created every year for the next 20 years. Can a microfinance strategy that focuses too broadly on enabling environments and technical assistance really be called upon to meet that need? Can an ena-

bling environment help those millions living in poverty in Africa? Can an enabling environment contribute on a broad scale to the empowerment of women in Afghanistan? I would argue that a strategy that encompasses both growth in direct service providers and strong enabling environments positions the US once again as a leading-edge promoter of overall, best practice microfinance.

Because funding goes almost directly to loan recipients, it is one of the most immediate ways to ensure US foreign assistance dollars end up in the hands of those in need in countries around the world—and with great results. Returns on investment for micro loans are enormous, ranging from 100–300 percent.

But there is much to be done. For every nation like Uganda where micro credit is beginning to show promise, there are others where the seeds have only just been planted.

The opportunity is there for the US and partner organizations to nurture these seeds, so that with respect, responsibility, and accountability—these individuals, these communities and these countries can do more for themselves than we could ever do for them.

In short, I believe through a more strict interpretation of the Microenterprise Results and Accountability Act by the Office of Microenterprise Development a balance can be reached in the funding of all sectors: enabling environments, technical assistance and direct service providers. The US remains a leader in microfinance, but, to maintain this role; it is imperative to fund direct service providers in addition to the policy sector as a whole. It is absolutely essential that we as a nation do not miss the opportunity to truly harness the full potential of microfinance on a global scale—a potential that can only be reached by funding retail services in an effort to build inclusive financial sectors.

Once again thank you for this opportunity. At this time I would be happy to answer questions from the committee.

Mr. SMITH OF NEW JERSEY. Mr. Yanovitch, thank you very much for your testimony.

Let me just begin with a couple of opening questions.

Dr. Morduch, you pointed out and you have made a comparison between Bangladesh, where 44 percent were found to be under the relevant cutoff, and then you talked about Uganda, where the sample found that those designated in the very poor was 15 percent. My question is, does that reflect the local modus operandi of the loan officers and the practitioners that are there on the ground in reaching out? Is it an outreach issue in trying to find who the poorest of the poor are? Is that why you have these large discrepancies or why we have them in terms of who are actually getting the loans?

And if you could, Ms. Cheston and Mr. Yanovitch, you both gave an example of a person who has dealt with the HIV/AIDS crisis, very, very compelling examples—different examples but compelling. You might have heard earlier, I asked Mr. Smith whether or not there is any active coordination with our own AIDS office or whether or not this is just a coincidence that they happen to be—what, how many individuals in the portfolio of loans are actually people who have been malaffected by AIDS? And is there an active effort in these countries like Uganda to find those individuals who could really—when we talk about who can actually help more people, when you have 12 or 15 orphans and individuals that are being helped, it seems to me that is another added extension of our HIV/AIDS policy, to reach out and help those people. So, is this coincidence or part of a deliberate strategy?

I notice, Mr. Plank, you mentioned—and I did ask this question of Mr. Smith, James Smith—about the relative cost between the for-profits and not-for-profits, and I wish I had read your testimony beforehand. I would ask specifically on this. But the WOCCU in the Philippines, $17 cost per client, and the contractor is $47 cost

per client. Mr. Smith indicated in his testimony that it is hard to break out some of these numbers. It is not always an apples to apples comparison, I think is what he was getting at. But I wonder if you could elaborate on that, if you would, whether or not—I mean, this is really disproportionate. The taxpayer would seem to be ill-served if we are not getting the kind of bang for the buck that the nonprofits can get compared to the for-profits.

And let me just finally ask all of you, if you could, the correlation with cuts in USAID technical personnel, which seem to be one of the reasons offered or proffered by James Smith, and why the for-profits have been in the ascendency in receipt of those grants. Or, is it just a move within USAID over the years?

We have noticed in the number of programs it seems to be the larger mega grant, as compared to the other grants, that seem to take more management on the part of USAID. Is there a correlation between those cuts in personnel and how we are doing business?

Dr. Morduch, I think, if you could go first.

Mr. MORDUCH. Let me first start by saying that the data from Uganda cover a range of different programs and the data from Bangladesh, also, 45 NGOs plus the Grameen Bank, which is not an NGO. I cannot speak to a particular organization, so let me just make some general remarks about why I think the patterns look like they do.

More than the issue being around what loan officers do, the big issue usually in outreach is the orientation of the leadership of the microfinance institutions. In many places, Uganda included, there is a sense in which, while the very poor need access to finance, the poor but not very poor and the not poor can also benefit from access to financial services. So one can have a successful social mission, important social mission, while not serving the very poor. And I think that is part of it. It is a commitment to serving a group that isn't very poor but still trying to make a difference. That is one part of it.

The other part has to do with cost structure. In Bangladesh, there are a lot of very poor people, villages are very dense, and the country is very densely populated. It is the most densely populated country on earth, and it is easier to reach a lot of people in a cost-effective way. Also, the structure of wages is such that it is easier to do it and still be financially viable. Whereas, in Africa, wages tend to be higher—I am speaking of wages for loan officers tend to be higher. So the margin, if you are trying to be financially viable, if you are trying to make profits, for an institution—it is just that much harder when you are reaching to the very poor when your costs are that much higher.

So a big part of it then is this balance that microfinance institutions always face in trying to reach the very poor but also to be very financially viable. And we are always trying to do both things at once. It is extremely difficult but somewhat easier to do in Bangladesh, and that is reflected in the data.

Mr. SMITH OF NEW JERSEY. Ms. Cheston.

Ms. CHESTON. One of your questions was about AIDS. This is an area where USAID has been a wonderful advocate. Opportunity International received a major award from PEPFAR in the first

tranche of funding; and that was from OGAC, the Office of the Global AIDS Coordinator. But it came about with significant advocacy on the part of USAID, for which we are very grateful.

We do see that there is an issue with pillars. To deal with an AIDS program in microfinance, you are crossing between the Bureau of Global Health and EGAT; and then to cross agencies further into OGAC adds another level of complexity. So what has happened is that this whole vital infrastructure, extensive infrastructure of microfinance in Africa is not being tapped because there is no place for that kind of program to be rolled out.

If you think about it, as of about a year ago there were 5.7 million microfinance clients in sub-Saharan Africa, and another 5.8 million credit union clients; and many of these clients were receiving loans through groups that are the perfect mechanism for delivering the kind of basic HIV/AIDS prevention and awareness training that can truly change behavior and have a sweeping impact on an entire community and reaching the most vulnerable people to infection, very poor women.

So we have an infrastructure that is ready to roll to reach the informal sector not reached by other means; and microfinance practitioners have been, usually with our own funds, doing everything we can to meet this. But with some basic incentives and some additional research and development we could roll this out throughout sub-Saharan Africa, but there doesn't seem to be a comfortable place where that mechanism fits right now.

Mr. SMITH OF NEW JERSEY. Could I ask you, on that, does the Global Fund—if you don't mind me interrupting—does it see the MERC and the synergy of the two working two efforts hand in hand?

Ms. CHESTON. To date, we have not seen an understanding that microfinance is a mechanism that can help them achieve their objectives. We would like to see more understanding of that from the Office of the Global Aids Coordinator.

Mr. SMITH OF NEW JERSEY. But also the Global Fund.

Ms. CHESTON. And the Global Fund as well. Generally, if you talk to a health practitioner, they will tell you that economic empowerment of women is a necessary part of any strategy to fight AIDS. It is essential. But figuring out where it is housed has been tough.

We did a survey several years ago, and our clients in Uganda were caring for an average of 2.3 orphans per client, and we actually expect that that number has increased significantly since then. So in terms of opportunities for prevention and awareness training, the ability to enable people to care for orphans and the ability to economically empower women so that they can avoid risky behavior and risky relationships, microfinance has a great deal to offer.

Mr. SMITH OF NEW JERSEY. Mr. Plank.

Mr. PLANK. Thank you for the questions, Mr. Chairman.

I think that the example that we put in about the Philippines was put there basically—if you would like more information, we would be happy to get back to you with that. But you can see from those numbers that we do believe we are better in many cases of delivering the service than the large contractors are, primarily because we are able to get down and work with the people on an on-

going basis rather than starting a project, coming back to it, back and forth. So our involvement is steady during the course of the project.

You can see that we reached the goals of that particular project, and we are quite proud of it. It is ongoing, I might add. And most of these individuals are women as well. It is nothing for us to see an auditorium full of 15,000 or 20,000 cheering women that have been successful in building their businesses. If you have ever participated in something like that, it is pretty heart-wrenching.

So far as the USAID funding mechanisms, it seems to me personally—and, again, I would be happy to let staff respond more fully at the board level. We don't get to do it on a day-to-day basis, so we just get to hear about staff's frustrations. I probably am being poked in the back right now, but I don't feel it.

At any rate, it seems it has sort of evolved to that. As Congress has seen fit to reduce the number of staff people within USAID, less and less people are there to put together these kinds of projects or to look at our proposals, and they are tempted to go with the large contractors in order to minimize the expense involved in employment. So though last year there was implementation money to hire some of those staff people, we haven't seen a whole lot of activity at this point in time.

I was going to use an old phrase from the west, but I think I will hold it, Mr. Chairman.

Mr. YANOVITCH. First, to the issue about HIV/AIDS, FINCA's experience in Africa is very similar to that of Opportunity National. We have over 120,000 clients in Africa, and in the survey in Uganda we found that over 80 percent of them were caring for HIV/AIDS orphans. When you typically go to a FINCA village bank in Africa and you ask the members to raise their hands how many are taking care of one, two, three, you know, clearly, it is sometimes three or four children. And what I think microfinance offers is the opportunity to help these families absorb the children, the orphans, and not fall into economic—even greater levels of economic destitution, to sell off their assets, et cetera.

One of the things in terms of a strategy is that microfinance organizations like FINCA have introduced insurance products, credit insurance products so that—because so many of the groups are based on a solidarity group guarantee where they are mutually guaranteeing each other's loans, to avoid any kind of discrimination the insurance will pay the cost of the premium in the case of illness or death; and that is a strategic partnership we have with AIG. We are also introducing with Gates Foundation a pilot initiative to do AIDS education in Malawi in conjunction with microfinance.

So we have not had as much exposure as Opportunity has to—some of these opportunities inside of USAID, but we would be interested, I think, as a community industry in pursuing that.

Turning to one issue I really am glad you asked about is the technical personnel. As I kind of draw a diagram and I think about microfinance, believe it or not, I have been in it now for 20 years. When I think about what it was like in the early 1990s, USAID had a network of really informed technical staff in each of the missions, and the relationship was between the direct service providers

and them. And the consultants would be called in to maybe do an evaluation, to do some technical assistance, and they had an appropriate role.

But I guess, as they reduced the unit, the number of technical staff, they decided to outsource. So the consulting—it wasn't just that the consultants are coming in between us and USAID. It is a whole firm. So now, instead of paying maybe, I don't know, $200,000 for one technical aid official, you bring in a firm for millions.

I can assure you, taxpayer money is not being saved in this formula. So my strong recommendation would be that you have technical aid personnel in microfinance. And, if not, just hire one consultant, not just an entire firm. They can be on a contract basis to the mission. Just one. And if you did that, you would solve most of the problems that we have talked about today.

Mr. SMITH OF NEW JERSEY. I really appreciate that.

Now we were working on the bill in 2003 and into 2004. I can tell you for a fact that when the for-profit consultants—and they are certainly due their day in court and to hear back from them—they were able to change through—no bill that I have ever worked on has ever gone through unchanged. It goes through numerous iterations. But they were very concerned that they were being—they would lose business, and they were able to get the bill changed.

You know, we didn't give in, either, those of us. As the prime author of that, I was very concerned about the impact contracting out was having everywhere in government, not just here but on USAID and so many other projects. And this goes for State and local government as well. It seems to cost much more, particularly over time, than advertised.

As you said, somebody with an absolute heart for this, that is, in-house comes with a much smaller price tag to the government and the taxpayers than when you bring the firm on board. As I think you just said a moment ago, and I agree with it, getting that one person with a very highly technical capability to look at something or whatever, that is prudent. But to move into that, I think eats away at what is then available for the person that this is all about, and that is the person out there who is getting the loan.

Let me ask you, Ms. Cheston—and I will just ask a couple more questions and then yield to my friend, Mr. Payne—in your testimony, you spoke about organizations, your coalitions that were willing to bring some $15 million to the table in private funds in Nicaragua, Honduras, Rwanda, Mexico, and yet you were excluded from competing for those USAID funds. Could you expand on this? And does USAID take private matching funds into account or funds like that, what you brought to the table, in its criteria for awarding funds? And what would be your recommendation for doing it differently?

And to all of you, if you could—I mean, I plan on having another oversight hearing on this very, very soon. We will be awaiting some of these reports from—as Mr. Smith indicated in his testimony. But while we were awaiting those reports, I thought maybe—or right when they come out—of holding another hearing of this kind—you

would all be invited back, if you would like to come—to really continue this process.

Because I am not convinced that the act is being implemented as aggressively or as faithfully as it could, and I mean no dispersions on those who are implementing that. And I say that we see this all the time.

You know, we need to be held accountable in Congress as well. I wrote the trafficking legislation, the Trafficking Victims Protection Act of 2000 and the 2003 Act. It wasn't until we held an oversight hearing—and I love this Administration. But it wasn't until we held an oversight hearing that the office was set up and that a whole slew of other aspects of that law—which all said shall, not may, shall do this, shall do that—actually were acted upon; and I always find that very disconcerting, that this pressure has to be brought to bear. But I guess we are all human, and unless you get a prod you don't do it. But we will hold another oversight hearing.

I also want to know what your thoughts are as to whether or not we should ask for another GAO report on this to pick up where the original one left off, coupled with the bill or the law and all of these insights that you are providing us to see how we can move this ball along.

But, Ms. Cheston, if you could speak to that $15 million and that issue you raised there.

Ms. CHESTON. Well, as I mentioned, Opportunity International has significant private support. There are certainly mechanisms within USAID where we are required to bring in some matching funds as part of those mechanisms, and Opportunity has very enthusiastically done that because we believe in leveraging the funds of the American taxpayer.

Just a few instances. We have a program in Honduras that is a leading microfinance institution there, and there was one award through an umbrella given in Honduras. We were supposed to be a sub to that award in that we were supposed to receive training and other services from the for-profit contractor. Our Executive Director told me—we have been lining up, we have been waiting, we have been calling them and asking for services. We were able to go to one training, it was a good training, and then we knocked on the door many times saying we are ready for the next step.

I have not shared this with my colleague from FINCA, but the contractor finally said, "You know, the funds are dried up; we don't have any more for you because they are all tied up in helping FINCA Honduras." So she happened to see the Executive Director of FINCA Honduras who said, you know, we haven't seen them since that one training, either. They did a little informal survey of the other leading microfinance institutions, and no one could figure out who they had been working with. So that was one example where all the funds for that country were tied up with this one award and a leading microfinance institution could not get access to those funds.

We went to Mexico, where we have a $4 million commitment of private funds. We were basically told by the mission director there that there would be a task order for a contractor, and organizations such as ours would not be able to benefit from that kind of task order.

We went to Rwanda. We have a $6 million commitment in private funds for Rwanda. And in conversations with the USAID missions recently, over several months, we have been told repeatedly that there is no possibility of any kind of matching funds from USAID in Rwanda.

We have a similar situation in Nigeria, where we came in and said we are willing to put up $5 million and again were told that this is not something that can be considered.

Mr. PLANK. Thank you, Mr. Chairman.

We would be just very pleased to continue hearings with this Committee. Being an observer of Congress and the GAO for the last 40-some-odd years, I would suggest that probably continuing dialogue with this Committee and the USAID would be much more helpful than another GAO report which eats up all kinds of staff time. We have already said staff is having a problem with meeting our needs. So it would be my observation anyway, that the GAO report would not be helpful or as helpful as more Committee work. Thank you.

Mr. YANOVITCH. I would echo that point. I would think that if we could have more of a dialogue between the industry, USAID, and the Committee—I have been coming here, again, for 20 years. This Committee has the longest institutional memory on U.S. microenterprise programs. It is this Committee's incredible diligence—and we have had Chairman after Chairman who has pushed for this program, Mr. Gilman among them; and I really believe, if you continue to engage in oversight, that is the best way to go.

I will just say, because—I just want to speak to Afghanistan for just a second, how this all played out there, because we know it is of great strategic importance to the United States. I went there right after September 11th to start a microfinance program. I could not find a way to get funding through the procurement processes. It took over a year for them to set it up. The normal process is they do these studies and they set up these big RFAs and RFPs, and it took me several years—I ended up going to private sources, and now FINCA has a very significant presence in Afghanistan.

Now the USAID mission director is very educated about microfinance, and he wants to make a heavy investment. But he happens to have had some training, and he is knowledgeable. So it does get back to making sure that they have this kind of technical expertise.

Mr. SMITH OF NEW JERSEY. I appreciate that.

If you all would consider what you think the technical—you know, how many people have been lost. We are going to ask—obviously, I asked Mr. Smith for that earlier; and I also will ask CRS if it can give us any numbers that it might have how there has been a—as technical expertise drops in USAID, the use of contractors goes up, and practitioners end up losing funding. We really want to get a better handle on that, because that is, I think, a major problem.

I also would just want to say that I would hope that none of you are in any way injured as a result of your testimony here. We had a very significant hearing on water just several months ago, and one of the men who testified from Millennium Water was immediately upbraided for providing very crisp but very, I think, knowl-

edgeable answers to questions posed by myself and other Members of the Subcommittee.

Frankly—and, again, I have a great deal of respect for this Administration, as I did for the previous one and for others. I mean, we have good, solid people working in these bureaucracies. But if there is retaliation for coming and speaking to Congress and providing the kind of insight that we think is absolutely necessary to craft good, responsive programs, that is something I will go to war on; and I know I speak for my good friend and colleague, Mr. Payne, as well. We have a right to know what is going on in the field and whether or not something is working.

One of the criticisms of Congress is that there has not been enough oversight of various programs. All we want to do is get it right and to maximize every dollar so that the targeted population gets what is intended, and that is in this case microfinance loans so that they can grow themselves out of poverty.

But if such a thing happens to any of you, I would like to know about it, we would like to know about it, because I have already requested a meeting, for example, with Ms. Natsios on Millennium Water which had first PVO status pulled and then it was put back and now they think they may not get funding. Time out. That is not the way this is supposed to work.

So whistle-blowers and people who speak truth to power, wherever it may be, very often become casualties, and sometimes they don't even know it. The word goes out. So if you hear anything like that, I want to know about that. And I say that with respect to my friends at USAID, because we just had a recent example, and I am very concerned and angered by it.

Mr. Payne.

Mr. PAYNE. Thank you very much, and I certainly couldn't agree with you more. I think that we have to really take the American taxpayers' money and use it most efficiently.

I, too, have a concern about, as we had a hearing on Millennium Water and found out, that the places with the most dire need for water were not even on the list and that the program was really being used for other purposes, I mean the place where they were in force needed some programs dealing with water. But the comparison of where, for example, in Africa and Niger and those places that are running out or have no water practically, none of those countries were even on this question about—I think they call it the Millennium Poverty Water Program or something that is just supposed to be the most abject places.

We are finding that, you know, the funds were being used for important things but more political kinds of, you know, Iraq and Israel and places where we have a strong interest but is not really, from the title of the program, being exactly where the greatest needs seem to be.

I just would like to also say that the cost per client that was put in through the testimony of Mr. Plank about the $7.2 million funding for 419,000 at $17 per client and the contractor being almost three times as much—I mean, once again points it out.

I think that at one point it was felt that if you kind of farm things out, it is going to save money in the long run, and especially with USAID, used to have country directors in practically every

country in Africa. Well, then they said we are going to save money, so we withdrew the country directors, and you will have a regional director that directs for six or seven or eight countries from one place, and it makes it almost impossible to do an effective job.

I think consultants are important, but I do think that there has been a shift in what a consultant was supposed to be. Usually you had a personal—they had the job, they did the job, and a consultant would come in and tweak things or perhaps help you with a summary or do some—it appears now that the consultant comes first and people in the field, you know, an organization that can do the job is sometimes brought in by the consultant at the end of the day; and that is just the reverse from what the inception of consultants when they started to creep in, you know, 20, 30 years ago. Now this thing has just ballooned out of proportion.

The difference between the for-profit and the not-for-profit—I am a big supporter of the credit unions. As a teacher 50 years ago was the only time I could even get a little piece of car because it was our own teachers' credit union that brought out the shoe box and went through the little index cards to find your name and write down your payment. But the payment rate is just unbelievable even in local credit unions, at churches and for teachers, and we have a big credit union here.

But we find that the big banks that you call and you want to just—they will give you eight buttons to push, none of what you want, and then they cut you off. And they are trying to knock out the credit union, that somebody is at the end of the line that you could at least ask a question of.

So I have followed that battle right along and support what credit unions do here and in the country, and the same philosophy abroad, I think, is very important.

Just a question to Mrs. Cheston. There has been an interest in—maybe I will just ask the question. Do you agree with the analysis that argues that microfinance institutions should limit themselves to banking only and that adding any other offerings like education, HIV, and AIDS prevention and those things should be avoided?

Ms. CHESTON. I do not agree. Thank you very much for the question, which indicates your concern about those kinds of integrated programs.

In my own organization, we have found that actually adding on client training in the context of weekly or biweekly group meetings can, in fact, increase the cost-effectiveness of the program as well as providing added value to the mostly women we serve. So we have found that adding on some basic business skills training, adding on training to support personal development, family issues that are troubling people, certainly health issues, these are all extremely helpful in providing a holistic kind of transformation.

We certainly believe in supporting the business when it is a case of a microloan, but it is hard to separate the business of a poor woman from her family and her community. So we have found tremendous impact that really is transforming communities.

We have one group of women who marched on their utility company and worked it out that they would bring electricity to their community for the first time ever, and that kind of grassroots political power came about as a result of a group of women coming to-

gether and talking not only about their loans but about the other issues that were confronting them.

I also would like to note that one of the innovations in microfinance moving forward has been that we are moving beyond strictly a business loan. We tend to think about the one woman who is receiving a $100 loan and investing it in a business, but, actually, microfinance has become much more sophisticated and we are going, as my colleague talked about, into microinsurance products that are very useful and savings.

One of the exciting things in our program in Malawi is that we started with a savings program first. We had a woman who could not sign her name, but she could give her fingerprint onto a little smart card, and she put her fingerprint on this smart card, and she deposited her savings in that smart card. Her husband died of AIDS a few weeks later; and her husband's relatives came in to seize all of her property, all of her assets, according to the custom there. They took her smart card, went to the bank; and the bank said, "Let us see your fingerprint. Does it match? No match. Sorry, you can't have these funds." So those were the only funds that she was able to retain, providing, of course, a tremendous benefit for women who have no power in the face of the AIDS epidemic.

Another example from the same program in Malawi is, one of the agonizing things for parents who know they have AIDS or HIV is believing that their children will not be cared for; and we have a new smart card where parents can put the smart card in the name of the child with the child's fingerprint. Then, if those parents die, that card belongs to that child; and the bank can even pay school fees directly to the school for that child using the funds in that smart card.

So there are a lot of things that we are doing in microfinance that are innovating—innovating in financial services and innovating in these integrated kinds of services; and what we really need is further incentives to do that kind of innovation.

Dr. Morduch spoke very eloquently about some of the potential for microfinance and the need for pro-poor innovation, and I think we have had an agency which has been phenomenal in providing incentives for increasing financial efficiency and financial sustainability. That is one of the things that USAID has created as an incredible gift to our industry and to the world. But now we need incentives that focus on how we can do the downreach to reach poorer and poorer unreached and underserved populations and how can we also expand that concept so that we are really looking at this kind of holistic client impact.

Mr. PAYNE. That is really great. I think that we really need USAID to—and we ought to look at the resources that have been cut. But we also need, as we mentioned, to talk about the manner in which they do business with this. It makes no sense that you have funds available but they are saying that they can't do the job. I mean, that seems like they are parlaying what you have raised privately with public funds, which doubles the impact.

I also think it is important—there was a move afoot at one point to say, well, maybe all we need is the trade rather than aid. You know, about a decade or 15 years ago, when other kind of trade discussion was going around, people were saying, just do the trade

and forget the aid. But I think there is another clear example—and even with the millennium challenge program of complicated—and you have to have good governance and all those things, which are important, and I think those countries that qualify are really going to have a great big boost. But, you know, some countries where there is a poorly run government and you have abject poverty, if it wasn't for—if you just went into Millennium Challenge Accounts and these truly needy people in countries that will never qualify would be left off.

So I think that we need the USAID, we need the Millennium Challenge, we need trade, we need all of it to continue, I think, to move forward.

In the Senate, there is—their language on microenterprise calls for $20 million to be set aside for HIV- and AIDS-impacted areas. The House bill does not have that kind of language. Do you—any of you could comment—do you feel a setaside of that nature should be something that we should strive for in the House bill, also?

Ms. CHESTON. Of course, we would love for that to be additional funding. You are not surprised, of course, by that answer.

Mr. PAYNE. Not at all.

Ms. CHESTON. Because, obviously, there is so much that can be done with the level of appropriation that we have, and then to have an additional fund to innovate further in HIV/AIDS would be very valuable. But even if that kind of plus-up is not possible, I think in general the members of the Microenterprise Coalition feel that we would support a carveout because we are so deeply committed to using our infrastructure to address HIV/AIDS and we would like to see that recognition of microfinance as a significant tool to be made.

Thank you for that question.

Mr. PAYNE. Well, thank you very much.

My last question is, if—and for each of you—if there was one thing or two—and probably we have discussed it already—but that you would like to see if you had the authority to do it to make the program more successful and relevant, what would be those things or that thing? And I will start and just go from my left to right.

Mr. YANOVITCH. May I just clarify? Do you mean the structure of USAID's program?

Mr. PAYNE. No. Just the microenterprise programs in general. If there would be a different emphasis or if there would be a—I guess the component of contractors, consultants to programs in the field with a proven track record.

Mr. YANOVITCH. Sure. Well, from the point of view of Washington, I think that I would echo Susy's statement that there is a tendency to have stovepiping so that we have the HIV/AIDS initiative on one side, you have economic growth on another side. But the reality in an African village is that they are having to deal with these problems all at once. So any kind of incentives to be able to bring these initiatives together, to encourage them to leverage their infrastructure, I think that there could be an enormous impact.

Again, FINCA has a network of several thousand village banks that are meeting once a week throughout Africa; and if they had access, we ourselves don't need to deliver the health education training. We can open the doors to other service providers.

But I think anything we can do to encourage the synergies and the alliances that would be really called for, and perhaps you could even organize a meeting to bring the parties together, that would be very helpful.

Mr. PLANK. Thank you, Congressman. I think I would go back to the three points I made in the conclusion: Number one, to ensure the effectiveness of microenterprise programs by enforcing central funding in the Microenterprise Development Office; and I think that is key, that we have someone there that is knowledgeable to be able for us to seek funds to do the work that we do.

Two, provide adequate funding for the USAID technical and acquisition personnel so large involved contracts are not necessary.

And, three, continue to encourage USAID to use instruments for which specialized practitioners can compete.

Now we are not trying to do away with large contractors, because they have a place as well. We are simply saying, give us an opportunity to get in there and we can, you know, for all practical purposes, do about $8 million in new business every year; and that is pretty modest when we are looking at the total budget that we are looking at here.

I think—if I could expand just a little bit on your education things too—the projects that we have in Ecuador and in the Philippines key very much on education and teaching self-worth, self-esteem, family rearing, family planning, on and on and on. You cannot just supply money to people and expect them to be successful.

I think the doctor made a good point, too. It doesn't take very long to take someone from so very poor to someone that doesn't fit into your definition of very poor, you know, certainly less than 2 or 3 years. The celebrations that these people go through when they learn that they have saved $70 or $80, which to us is a dinner or something, these people are so proud of being able to do that. It is good sometimes to be able to be involved with them when they are having their celebrations, and I have been fortunate enough to do that several times now.

The last point I would make is that whenever you are involved with poor people and you make them a loan to perhaps—I remember one of our clients had cooked meals so that when workers in the morning were coming by they could buy meals from her. You know, it is good to teach them how to do that and they are making income from that. But it is also good to make them start thinking from a business standpoint; and, while they are looking at those pots and pans, learn that they could sell those pots and pans and make even a better businessperson. So those are the kinds of step-up things that we attempt to do.

Thank you.

Ms. CHESTON. I heartily concur with my colleague's comments and would like to add that, for me, it starts with developing a global strategy and a global vision. That is something that we don't see right now from USAID. It would be very helpful to look at the industry, how many people have we reached, how many people can we reach, what do we need to do in order to accomplish that and, really, to create a global vision for the growth of microfinance?

As part of that, I very much appreciated James Smith's comment about economic growth. There are some very good people at USAID who understand how to do this, but, right now, that kind of economic growth paradigm as an engine for poverty reduction isn't embraced as it should be at the highest levels of the Agency and not for lack, I think, of expertise within the Agency about that. So having economic growth be part of that vision and part of a renewed focus on the part of the Agency, I think, would be very helpful.

The second point is, as I said in my remarks, supporting retail microfinance. You know, you can do a lot of things to build a market to create an ice cream industry, but if there is no place for someone to go buy an ice cream cone, you haven't really accomplished much. So how can we create a place, a vehicle where the poor people can be provided with direct services? That is part of the current strategy that we see lacking, or a lack in that emphasis right now within the Agency.

The third point is kind of similar to the point I made, in response to your wonderful question earlier. It is a question of incentives. USAID has done a terrific job of developing market leaders, of providing some real innovation and research and development and really focusing on financial efficiency and financial sustainability. But when we talk about efficiency and cost-effectiveness, I so appreciated Chairman Smith's remarks at the beginning of this hearing where we must not lose sight that cost must be paired with effectiveness, and that efficiency is not all there is and that the point is the kind of change we want to see in people's lives and whether we are truly reaching the poor. So it would be helpful to have that kind of renewed emphasis and incentives for programs to focus not solely on financial effectiveness and efficiency but also on holistic client impact, the kinds of training that we have been talking about, reaching unserved and underserved populations, and doing more to reach women.

Again, the Agency has done some very innovative things in encouraging downreach in certain missions to reach women more effectively. That kind of program can be done. There is a lot that we know about how to reach poor women effectively that has not really been acted on lately because of lack of incentives.

And, of course, that whole issue of reaching as far as we can to reach the poorest people we possibly can, recognizing that it is a challenge and we all know it is a challenge. If it were easy, there would be plenty of commercial institutions doing it, and we wouldn't have a job, and we would be grateful for that.

Mr. MORDUCH. I want to underscore the points that were just made and just add one issue, picking up on Susy Cheston's point about a global strategy and a global vision. When the President started the Millennium Challenge Corporation and the Millennium Challenge Account, it was designed in recognition that American taxpayers deserve to know how money is being spent and to know the social impacts of that money and the cost-effectiveness of that money. Microfinance is powerful because it has the capacity to provide the kind of cost-effective solutions that the Millennium Challenge Account was all about. Part of the spirit of the MCC, though, was the commitment to collect data, do rigorous impact evaluations

and put things on the table. Taking that step in microfinance and in other areas, and USAID taking the lead in that area again would be a major step forward. This is one area, basic research, where robust, rigorous evaluations have fallen by the wayside.

Taxpayers deserve to have good data on what is happening so that we can build from our understandings, complete understandings, and can move beyond anecdotes toward rigorous data on what is happening. USAID had taken the lead a few years ago with AIMS projects which tried to do exactly this, but in the last few years that agenda has been much less strong, and it is time to develop it again.

Mr. PAYNE. Let me thank you very much. I think we all agree that USAID is important, and we would like to support it. I think your comments, though, might be helpful for them. There are people who are not as supportive for USAID as the Chairman and I and others. So I think that if we can come up with constructive criticism to make the Agency even more proficient, then we might win over some of the naysayers that feel that even foreign assistance is passe.

Just, finally, you know, consultants is not—this outsourcing is just the way that it is done. When I first got elected to Congress, I was in the Federal Government, I was happy, and the first thing that happened was that all of the custodians—this is 17 years ago—came and said we have all just been terminated. They had been working for the Federal Government for 30 years. They said, we are outsourcing it and we are going to bring in a contractor who is going to—and that happened there, and it just happens time after time after time after time. The consultants come in with the plans, and it is unfortunate. I mean, you would probably be shocked to know that we almost have over 100,000, maybe 125,000 contractors in Iraq. Almost at some point contractors will exceed the actual service people. Now that is unbelievable. And they don't show up on charts.

But, you know, the old days of the soldier used to have KP duty and he used to cut the peel off the potato, they tell me. Now maybe that is not the best use of a soldier; however, now you don't do that anymore, but you have a tremendous number of contractors.

So I think there needs to be a balance, and that is what you are talking about, and contractors—not contracts so much, but consultants consulting, helping out, putting the final polishes on it. But when they are the prime movers, then we are really kind of in trouble, when all the money stays on K Street, regardless of what administration is there. Just the street stays, the administration comes and goes. But that is where we have to start perhaps changing that culture that is live and well down here in Washington, DC.

Thanks, Mr. Chairman.

Mr. SMITH OF NEW JERSEY. Let me just ask a couple of final questions, and you have been so generous with your time. On the issue of conflict and natural disasters, Ms. Cheston, you mentioned a moment ago the global strategy—and I appreciate your understanding of what—all of you, what is the current global strategy and where you think it ought to go.

With regards to such things as conflict, though, the GAO, as you know, made mention of the Kovosar Albanians and then that the

microcredit financing didn't work all that well in that instance. But I am sure there are many others where it would and would work very effectively.

And, secondly, in natural disasters, when I was in Phuket and then we went to Thailand, when we were in Banda Aceh, when our group went over to Sri Lanka, a major part after the immediate recovery and getting clean water was microfinancing and credit so that people could buy those small boats. While we heard it from individuals, we definitely heard it in a very strong way from the government; and I would be wondering what your sense is of how well we have responded to that and whether or not it was just a matter of diverting money that is already in the pot so that other microfinancing didn't happen somewhere else but it was diverted to, in this case, the tsunami-ravaged areas.

Finally, I mentioned CAFTA earlier in my questioning of Mr. James Smith about whether or not there is any effort being made to help the losers in a free trade agreement. In the end I ended up voting against the CAFTA agreement. A lot of well-meaning and, I think, very concerned individuals voted for it. As you know, it was very narrowly approved.

When you talk about CAFTA and the other trade agreements that have occurred, there are always losers. Very often there are new losers. They may have not been making it all that much before, but now they are demonstrably in the loss column. I heard directly from individuals who said that they need microcredit loans or else they go under, and they go under big time, or they all flock to San Salvador for the non-jobs or maybe the hope of jobs that may materialize someday.

I know, Doctor, you mentioned in essence a rising tide, raising the boats, when you talked about economic growth and all. But, again, these real losers; are we addressing those people who fall between the cracks, like when the CAFTA is enacted? But, again, conflict, national disasters. If you can touch on those.

Ms. CHESTON. I will just mention about conflict and national disasters. There is a body of knowledge about how to bring microfinance to those kinds of situations. Dr. Morduch's plea for more data is one that I would very much support because of one example of a World Vision program in Ethiopia where they had a severe drought, and there was a thriving microfinance program. And they did the study, they got the data, and one of the things that they determined was that there was a significant decrease in the amount of food aid required among those clients who were participating in microfinance programs, and that there were significant improvements in nutrition not only for the clients themselves, but also for their children as a result.

So we can see real measurable improvement as a result of microfinance programs, including in some disaster and postconflict situations.

Mr. SMITH OF NEW JERSEY. Is that money derived from the microfinancing account, as far as you know, or is it under some disaster relief heading? In other words, are we robbing Peter to pay Paul; Africans end up losing if we send the money to Asia or somewhere else, or vice versa?

Ms. CHESTON. I really don't know the answer to that question. There was a $20 million fund for microfinance support for tsunami relief specifically to address these kinds of issues, and yet at the same time Opportunity was responding to an RFP that had been put out and suddenly was told there was no money available for microfinance.

So we are still trying to figure out where that fund is. It is probably there somewhere, but we can't figure out where it is housed and how to get access to it. So if you figure out the answer to that question, I would very much love to hear it, Chairman Smith.

Mr. YANOVITCH. I would like to hone in on the topic of conflict, particularly having spent a lot of time in Afghanistan of late. And to start off cueing the point about Kosovo. FINCA started in Kosovo right after the war there, and what we found is that microentrepeneurs were, in fact, sort of the first agents of distributing goods; that there was a very vibrant microentrepreneurial sector and a very big demand, and we were able to establish a program that grew and is now flourishing to this day.

In Afghanistan, as in Kosovo, one of the major issues we face is security, and particularly with microfinance programs because they are cash-based, and you are distributing cash loans, et cetera. And I can say that the program is flourishing in Afghanistan, but our number one problem is the security issue. And there have been over 40 humanitarian workers who have been murdered in Afghanistan. Steve McQueen, who headed the microfinance facility of Afghanistan, was assassinated earlier this year, and that investigation has not gone forward very rigorously.

And I would suggest that for the Committee, putting humanitarian workers—I think we are all willing to go out and risk our lives, but I do think the U.S. has to look more closely at some of the security issues around humanitarian workers.

Turning to your other point about trade. One of the messages we often get, for example, in the Latin American region of USAID is there is a big push on trade, and for that reason there isn't any money for microfinance. An argument we would like to counter is a lot of microfinance is for trade finance, except it is at the micro level, and what we are really doing is financing trade between villages and secondary towns and capital cities. And the degree which they could be seen as a trade pyramid, where you are working at all levels of the private sector, not just the upper tiers, but also the microtraders at the bottom. I think any initiatives on that score would be very helpful.

Mr. PLANK. It is a very complex question, and we also have a project going in Afghanistan, and speaking from a board standpoint, we are very reluctant to send employees into that kind of personal danger. The former Chairman Bobby McVey, who is a Canadian, visited Iraq recently—Iran; excuse me. There are a number of credit unions in Iran, and perhaps when the State Department says it is okay for them to be members of the World Credit, they will become members of the World Council.

You know that in Muslim countries, or maybe you don't know, it is extremely difficult for lending institutions to operate. They do not believe in interest, and therefore, you can't pay interest. So they are a little different, but nonetheless they are still taking care

of people's needs. I suggested it was very nice the Canadian was going there. As an American, I would stay home.

We have been asked in several interesting quarters to become involved in Iraq. The most interesting, I think, was the President of the current legislature's son who visited some people in Tucson and happened to mention that he was involved in the credit union, so it came to us that way as well as through some of the agencies that would like to start credit unions there. But, again, from a board standpoint, if we can't find a way to protect our individuals, our people that would work there, we would be very reluctant.

Of interest perhaps, since you mentioned Sri Lanka, Mr. Chairman, we lost over 200 credit unions in that disaster. The United States credit unions and, frankly, some from around the world as well have contributed over $700,000 to rebuild those credit unions, and we are in that process right now. So we believe as we rebuild those credit unions, we will be helping to take care of some of the needs that you are speaking of. But in some cases, as you know from being there, the entire village floated away, which included all the credit unions' records plus all the people. So it is a disaster that we are monitoring very closely.

We find ourselves in about the same position now with helping our brothers and sisters in New Orleans. We have gathered probably a little over a million dollars for that disaster at this point in time, plus bringing in mobile branches and getting ATMs up and so forth so that people can have access to their funds. So we get very involved. I will stop there because the list goes on and on and on.

But in the area of CAFTA, we have very strong relationships in Central America. We have over 550,000 members in Guatemala; El Salvador, 80,000; Honduras, 400,000-plus; Nicaragua, 35,000.

I enjoyed the question to Mr. Smith when you asked—you didn't ask, the other Congressman asked, "Do they know who you are?" My first trip when I was a very new Director on the World Council was to Nicaragua, to our project down there. I was with the CEO of World Council, and we had talked for maybe the better part of 3 hours with the credit union manager, who was in the back room of a very small shop. And finally he looked at us and said, "Just who are you again?" So it is not very apparent who you are. Thank you.

Mr. MORDUCH. I want to say something which I think is fairly obvious about disasters and conflict situations, and that is that when a disaster happens or a conflict happens, it affects a broad group of people. Some are very poor, some are less poor, some are low income, and everyone is struggling, of course.

What we are finding is that a broad range of people can benefit from microfinance, and that is the power of what is happening in the programs my colleagues are running. And the obvious thing that I wanted to say is that I would hate to imagine if it ever happened that the target in the legislation of reaching the very poor, 50 percent of the money should be targeted to the very poor, I would be disappointed if that target got in the way of these other important initiatives which would probably be targeted to a much broader population. That is a tension going forward.

Mr. SMITH OF NEW JERSEY. I would like to thank all of you for your testimony and look forward to working with you as we go forward. Again, keep up the great work.

The hearing is adjourned.

[Whereupon, at 5:15 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

SUBMITTED FOR THE RECORD BY THE HONORABLE CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY AND VICE CHAIRMAN, COMMITTEE ON INTERNATIONAL RELATIONS



STATEMENT OF ALAN CHVOTKIN
SENIOR VICE PRESIDENT AND COUNSEL
PROFESSIONAL SERVICES COUNCIL

STATEMENT FOR THE RECORD

SUBCOMMITTEE ON AFRICA, GLOBAL HUMAN RIGHTS
AND INTERNATIONAL OPERATIONS
COMMITTEE ON INTERNATIONAL RELATIONS

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 20, 2005

OVERSIGHT HEARING ON THE MICROENTERPRISE RESULTS AND ACCOUNTABILITY ACT OF 2004

Suite 750, 2101 Wilson Blvd. Arlington, Virginia 22201
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Mr. Chairman, members of the Subcommittee, on behalf of the nearly 200 members of the Professional Services Council (PSC), thank you for the invitation to submit this statement for the record at this important oversight hearing on the implementation of the Microenterprise Results and Accountability Act of 2004 (Public Law 104-484). I am the senior vice president and counsel for the association. PSC and our members are strong supporters of the microenterprise program and of USAID's implementation of this law and the microenterprise initiative. While certainly more can be done, we believe that Congress has provided a solid policy foundation upon which to build a world-class program. Chairman Smith, through your leadership and that of this Subcommittee, the microenterprise program is among the premier programs in international economic assistance.

As you know, PSC is the leading national trade association that represents almost 200 member company businesses of all sizes providing professional and technical services to virtually every agency of the federal government, including information technology, engineering, logistics, operations and maintenance, consulting, international development, scientific, environmental, and social sciences. Many of our member companies are among the leaders in providing international development assistance around the globe under contracts awarded by the U.S. Agency for International Development (USAID). Several of those companies are already active participants in the agency's microenterprise program.

Over the past four years, Congress has enacted three statutes relating to the microenterprise programs of the federal government. The first, the "Microenterprise for Self-Reliance Act of 2000" established the core program. The second, Public Law 108-31, enacted in 2003, revised the program and focused efforts on the poorest populations in developing countries. Then in 2004, the "Microenterprise Results and Accountability Act" focused on the structure of the USAID program, emphasized two important program goals of achieving results and demonstrating accountability, and re-emphasized targeting assistance to the very poor.

As we discussed in PSC's March 12, 2004 letter to Chairman Hyde and other members of the House International Relations Committee during its consideration of H.R. 3818, the committee's original version of the legislation that became the 2004 law, PSC fully supports those goals and we endorsed the preponderance of the legislation that this subcommittee created. We were strongly opposed then, as now, about efforts to inappropriately and unnecessarily exclude U.S. private sector consulting firms from participating in that USAID program, even though many of those firms currently provide valuable services and expertise to USAID and to beneficiaries around the world. A copy of that March 2004 letter is attached to this statement.

We also reviewed the findings in the Government Accountability Office's (GAO) November 2003 report (GAO-04-171) and after extensive discussions with our members and the agency, concurred that the program has been able to demonstrate success through the contracts and assistance arrangements that the agency used in meeting some of the key objectives of the program Congress established through the 2000 and 2003 laws.

By the same token, we joined with many others in recognizing that USAID's internal "results" reporting mechanisms for this program were limited and needed improvement. We believe these limitations led to the conclusions reached by GAO and that prompted Congress to spell out the details of the monitoring system (in new 22 USC 2211b) and the requirement for USAID to develop and certify poverty measurement methods. With respect to the microenterprise program, we are cautiously optimistic that the proposed revised results reporting system will fill in many

of these gaps. Regrettably, this same concern can be lodged against many USAID programs. The agency is simply behind the curve when it comes to having the necessary systems and capabilities in place to report meaningful and timely results on many of its key programs, or even to be able to accurately record and report the details about many of the transactions that have been made.

Beyond these limitations, some of the concern raised about the microenterprise reporting system stemmed from an honest disagreement on the appropriate standards to be measured; other deficiencies arose because the agency did not have an opportunity to fully integrate the 2003 congressional directive to focus on its poorest clients.

I am pleased to tell you that PSC and our member companies met last year with officials from the USAID Microenterprise Office to discuss the extensive experiences our members have with delivering microenterprise assistance around the world. We continue to offer our assistance in developing improved methodologies and data elements to improve the annual results reporting system. While more work remains to be done, we are pleased with the progress that has been made to date.

Mr. Chairman, one of the key points of discussion during last year's congressional consideration of this legislation was the preference for specific funding mechanisms that would be used to deliver the microenterprise program assistance to clients. We fully endorsed the language of the 2003 law that assistance "shall meet high standards of efficiency, cost-effectiveness, and sustainability and shall especially provide the greatest possible resources to the poor and very poor." (22 USC 2211a(b)(2)(C)). In our communications with the committee and with others, we highlighted that both contractors and implementing partner organizations can and do meet that standard. We encouraged the committee to ensure that USAID, whether in its headquarters or through its missions, has the flexibility to use all of the resources available to it to carry out its program.

We particularly appreciate the dissenting views in the Committee's report accompanying the 2003 legislation, and the support by your colleague, Congressman Jeff Flake. I have attached those dissenting views from House Report 108-459 to my statement. We also join with a large coalition of other small business organizations and several non-profit organizations that receive both contracts and grants. We share a common goal of ensuring that our services are available to USAID to compete vigorously for the opportunity to bring our individual capabilities and resources to meeting agency mission needs. The coalition remains in place today as we continue to work with USAID on the implementation of the 2003 law.

It is regrettable that there continues to be a focus on the funding instrument – acquisition versus assistance – instead of results and accountability. Congress has been very clear about the factors a federal agency must consider when using taxpayer dollars for determining whether to use a grant, a cooperative agreement or a contract. Each of these funding approaches has their advantages and disadvantages. Many contractors and grantees have their own advantages and disadvantages based on their experience and capabilities. Unquestionably both the acquisition and the assistance communities would like to increase their share of business derived from USAID. Ultimately, it should be the agency that determines the most appropriate funding mechanism to meet its various needs and best serves the client recipient.

We have also expressed our concern to USAID about elements of USAID Administrator Natsios' September 19, 2005 Executive Message regarding this program. While the core of that message properly directs the agency's action on the implementation of the 2004 law, we believe the Administrator overemphasized the funding approaches and failed to focus sufficiently on the developmental assistance to be accomplished or the needs of the recipients of the funds.

Mr. Chairman, the USAID microenterprise program is one of the premier international programs designed to provide long-term sustainable economic self-sufficiency opportunities for the poor of many nations. We know the value of entrepreneurship in this country and the contributions that smaller businesses can make to the United States' own economy and quality of life and share in the support of making those opportunities available outside the U.S. The three laws already enacted addressing the microenterprise program set a solid foundation for our nation's program and for USAID's activities although we recognize that more work remains. PSC member companies are pleased that we are an integral part of the USAID program delivery team. We look forward to working with this subcommittee and USAID on the program oversight as well.

Thank you again for the opportunity to present the views of the Professional Services Council. We look forward to working with this Subcommittee and USAID to ensure that the microenterprise program remains one of the premier U.S. Government international economic development assistance program.



PROFESSIONAL SERVICES COUNCIL

March 12, 2004

The Honorable Henry Hyde
Chairman
Committee on International Relations
House of Representatives
Washington, D.C. 20515

Re: H.R. 3818: Microenterprise Development Program Revisions

Dear Chairman Hyde:

On February 25, the House International Relations Committee ordered favorably reported legislation (H.R. 3818) that seeks to improve the U.S. Agency for International Development's (USAID) microenterprise development assistance program. However, the legislation would also inappropriately and unnecessarily exclude all U.S. private sector consulting firms from participating in that USAID program, even though many of those firms currently provide valuable services and expertise to the Agency and to beneficiaries around the world. The Professional Services Council (PSC) is strongly opposed to this exclusion.

PSC is the leading national trade association representing the professional and technical services industry doing business with the federal government. PSC's approximately 155 member companies provide information technology, high-end consulting, engineering, scientific and environmental services, among others, to all agencies of the federal government. Many of our member companies support USAID, including implementing worldwide key microenterprise development assistance programs for the Agency.

PSC member companies and other private sector firms have a long history of providing a high level of quality to USAID and to international beneficiaries. These firms add significant value to USAID's program execution in areas ranging from loan delivery, legal and regulatory reform, and the creation of industry infrastructure that serves a broad group of international microenterprise development organizations. Thus, we are very concerned about excluding from participation those tax-paying U.S. entities that are highly accountable to the congressional program goals, given the contractual nature of their business relationship with USAID.

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It is ironic that Congress would even consider excluding such firms from participating in the Agency's programs, and in the USAID microenterprise program, in particular, since the purpose of this program is to foster economic development through private, for-profit, enterprises working in free markets.

We see no policy or programmatic reason to change the eligibility of vendors who may be called upon by USAID to meet the needs of the beneficiaries, or to change USAID's structure or mechanisms for delivering such services. Any time competition is reduced, quality could be affected and cost could go up. Beneficiaries suffer, as does USAID's program performance, and so, too, does the U.S. taxpayer. We urge you to ensure that private sector development firms are provided a full and fair opportunity to participate in this successful USAID program.

Thank you in advance for your attention to this urgent request. If you have any questions or need any additional information, please do not hesitate to let me know. I can be reached at (703) 875-8059 or at Chvotkin@pscouncil.org.

Sincerely,



Alan Chvotkin
Senior Vice President and Counsel

cc: The Honorable Tom Lantos, Ranking Member
The Honorable Chris Smith

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108TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { 108–459

MICROENTERPRISE RESULTS AND ACCOUNTABILITY ACT OF 2004

APRIL 2, 2004.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HYDE, from the Committee on International Relations, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 3818]

[Including cost estimate of the Congressional Budget Office]

The Committee on International Relations, to whom was referred the bill (H.R. 3818) to amend the Foreign Assistance Act of 1961 to improve the results and accountability of microenterprise development assistance programs, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

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29–006

DISSENTING VIEWS

Mr. Chairman, I wish to express my dissenting views on this legislation, but first I want to emphasize my support for accountability at all levels and branches of government. I am outspoken about my concerns over wasteful use of taxpayer money, and these concerns factor into my opposition to the bill as considered by the committee.

In particular, I am concerned about provisions in this law that exclude for-profit, private sector consulting firms from participating in the U.S. Agency for International Development's microenterprise development program. Many of these firms currently provide valuable services and expertise to the Agency and to beneficiaries around the world and do about 20 percent of USAID's work in microenterprise development. For-profit firms add significant value to USAID's program implementation in areas such as loan delivery, legal and regulatory reform, and the creation of industry infrastructure that serves a broad group of international microenterprise development organizations.

Excluding for-profit firms eliminates an important participant in the bidding process for contracts. If we eliminate this sector of this industry from bidding, we also eliminate potential cost savings and efficiencies that result from competition. When competition is reduced, costs rise and quality declines. Beneficiaries of the microenterprise program, USAID's performance, and U.S. taxpayers would bear the brunt of such decline.

Competition for contracts is not only beneficial on the front end of the contracting process, but the potential for future contracts gives incentives for all industry players to demonstrate their value in the execution and completion of contracts. By not including these tax-paying U.S. entities from participation, we eliminate contributors that are accountable to the congressional program goals by virtue of the contractual nature of their business with USAID.

It is ironic that in a program intended to foster entrepreneurship and for-profit enterprises in developing and free markets around the world, we propose to limit the participation of such enterprises in the very execution of the program.

I urge you to ensure that private sector development firms are allowed to continue to participate in the USAID microenterprise program.

JEFF FLAKE.

○

○