What (Not) to Expect of Microfinance in Haiti

Testimony for the House Financial Services Subcommittee on International Monetary Policy and Trade

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April 28, 2010

Thank you Chairman Meeks, Ranking Member Miller, and other members of the subcommittee. I appreciate the opportunity to appear before the subcommittee to discuss how the U.S. and international institutions can support the private sector in Haiti following January's earthquake.

My testimony here will have two main parts: a quick list of ideas on the challenging terrain faced in supporting Haiti's private sector; and a fuller discussion of what we should and should not expect of one popular intervention: microfinance.

Ideas for supporting Haiti's private sector

- *First, do no harm*. Some aid efforts, both public and private, have imported into Haiti goods and services that could be supplied locally, such as rice and IT consulting. Such practices stall the recovery of Haiti's farmers and entrepreneurs, and donors should halt them. As Center for Global Development president Nancy Birdsall testified on March 16, this may be a place where the Congress has become part of the problem, by imposing strict procurement rules on U.S. aid agencies. Put positively, this may also be a prime opportunity for Congress to help Haiti, by at least granting an experimental, Haiti-specific waiver for some rules.

- *Any strategy for supporting Haiti's private sector must recognize the great divide within it*. Perhaps half a dozen families, white and light-skinned, control much of Haiti's formal, legal private sector, the part most analogous to what Westerners envision as "the private sector." Meanwhile, the vast majority of Haitians get by in informal economic activities such as farming and petty trading. Though the fates of the two economic groups are intertwined, efforts to help one should not be equated with efforts to help the other. We should not underestimate the challenge of breaking down the barrier, nor confuse it with efforts to meet the short-term survival needs of the majority.

- *While outsiders strive to "build back better," locals will start to build back the same. For example, Haitians will begin to rebuild their slum dwellings in the traditional patterns—if they haven't already. This argues for giving cash to Haitians in order to empower them in the process of recovery and stimulate the private sector.*

I don't mean to draw a black-and-white distinction here: no part of Haiti will be built back quite the same. Post-quake Haiti will blend pre-quake Haiti and new influences. The point is that, even knowing they will often build back the same, we should trust Haitian people as least as much as we trust Haitian and foreign government agencies when it comes to engineering efforts to recover. Individual Haitians are generally better placed than we are to know and meet their needs. And the U.S. government has sometimes failed when it tried to "build back better." After the Managua earthquake of Christmas 1972, USAID built rows of earthquake-resistant huts far from centers of economic activity. Instead of the people coming to the new homes, the homes came (piece by piece while guards looked askance) to the people—that is, to where the people had lived and would continue to live.[1] History is repeating itself in Port-au-Prince as we speak, though whether the U.S. is involved this time I do not know.[2]

Thus for the sake of recovery—and recovery that leverages Haiti's private sector—there may be a role for direct delivery of cash to Haitians. They will use the money as they see fit, spending it on food and building materials, stimulating the private sector. The results will not be ideal, but neither are those of donor-run projects. (Calls for a Marshall Plan for Haiti are ironic in this light since the original Marshall Plan succeeded by largely helping Europe build back the same.)

- *The cash-based strategy of helping Haitians help themselves faces several challenges. One is the capacity of the damaged Haitian economy to supply what Haitians would demand (in the economic sense) with that money.* USAID has done some excellent "market mapping" to identify bottlenecks—such as lack of small-scale warehousing—that could obstruct flows of rice, beans, and corrugated iron sheeting.[3] This analysis is pointing to high-leverage opportunities to rejuvenate the economy. And by identifying what the private sector can and cannot supply, it is providing crucial guidance for "doing no harm" in the sense above.

- *Another big challenge to cash delivery is…cash delivery. Several options for disseminating purchasing power should be considered. One is traditional cash-for-work programs; some are underway now. Another involves piggybacking on two formal systems that reach large numbers of Haitians: remittance flows and mobile phones*.

A third of Haitian families reportedly rely on money from members living abroad (remittances). 70–90% of families have access to mobile phones, with numbers at the higher end in worst-affected Port-au-Prince. Perhaps "top-ups" could be tacked on to those remittances through Western Union and MoneyGram. Or if mobile phones could be turned into small savings accounts, as happened most famously in Kenya, donors could with a stroke of the pen increase the balance of every Haitian

[1] Story from Stuart Rutherford, author of *The Poor and their Money*, and an ActionAid employee in Nicaragua after the quake there.
[2] Carrie Kahn, Poor Planning Mars Haiti's Efforts to Move Survivors, *All Things Considered*, April 19, 2010, http://www.npr.org/templates/story/story.php?storyId=126025145.
[3] "Note from Haiti: Improving Relief Efforts through Market Mapping," April 7, 2010, http://www.microlinks.org/ev_en.php?ID=43044_201&ID2=DO_TOPIC.

with a phone number.

What (Not) to Expect of Microfinance in Haiti

Nowadays it is impossible to talk about supporting the private sector in poor countries without talking about microfinance. Recently, I have been writing a book and maintaining a blog dedicated to clear-eyed analysis of the impacts of microfinance. A colleague recently paid me what I consider a high compliment: he called my work critical but not cynical. I will explain both those adjectives.

Why I am not cynical

A couple of years ago I spent a good deal of time scrutinizing what was then the leading academic study of the impacts of micro*credit*.[4] To decide whether I believed the conclusion that microcredit in Bangladesh had helped families, especially when the loans were made to women, I decided to *replicate* the study, applying the original statistical methods to the original data. The math and computer programming were really complex. In time, with my coauthor Jonathan Morduch, I would conclude that the study does not stack up. We're not saying microcredit doesn't help people, just that you cannot judge the matter with the data in this study.[5]

Now, during this project I visited several microfinance programs, including two supported by USAID in Egypt. I will never forget the scene I witnessed in one of Cairo's poorest neighborhoods. Hundreds of women had thronged to a microcredit bank branch to get their new loans. Most had just repaid old ones. The crowd—the women and their children—jammed the lobby and overflowed into the hallway and staircase beyond, and down onto the street. They waited hours. I thought, "Should I tell these women that on my laptop back at the hotel, I had been crunching numbers that suggested that 'we' are not actually sure if microcredit is such a good thing?" Of course not! Who was I to tell them how to live?

I reflected on this paradox, this conflict between the uncertainty of the research and the vitality of the scene. I took *both* seriously. I realized that several different ideas of "success" are in the air when people talk about whether microfinance "works." Microfinance does better by some of these definitions than others. This realization is the heart of my book.[6]

Why I am critical: Evidence lacking that microcredit reduces poverty

We have all heard microcredit success stories—about the woman who uses a loan to start a small business making clothes or selling vegetables, about how she expands the business, hires people, and gives her children a better life. There are many such stories, and I assume many are true.

But while there is some persuasive evidence that microfinance stimulates microenterprise, *we have little solid evidence that microcredit, the dominant form of microfinance, reduces poverty.*

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[4] Mark M. Pitt and Shahidur R. Khandker. The Impact of Group-Based Credit on Poor Households in Bangladesh: Does the Gender of Participants Matter? *Journal of Political Economy* 106(5): 958–96, 1998.

[5] David Roodman and Jonathan Morduch, The Impact of Microcredit on the Poor in Bangladesh: Revisiting the Evidence, Working Paper 174, Center for Global Development, June 2009.

[6] Draft chapters are on David Roodman's Open Book Microfinance Blog, http://blogs.cgdev.org/open_book.

That is a strong statement. Why am I convinced of it?

- *There are "failure stories" too in microfinance.* In late 2007, for example, *BusinessWeek* told the story of Eva Yanet Hernández Caballero in Mexico, who got in over her head with high-priced microcredit.[7] Anthropologists who have spent time in villages in Bangladesh have told of women whose pots and pans or tin roofs were taken by their neighbors and sold in order to repay loans for which the neighbors would otherwise have been liable.[8] We know that in the United States loans are sometimes a boon—responsible mortgages, college loans—and sometimes a bust. We should not be surprised that the same is true for microcredit.

- *It is extremely hard to determine cause and effect in households, villages, and slums.* The challenge of research is to sort through the diverse stories of failure and success, find patterns, and infer causal connections. But if I show you a successful microcredit borrower with plump children and a non-borrower unable to feed her children every day, you can imagine many ways to explain that pattern. Maybe microcredit really made the difference for the first woman. Or maybe she was better off to begin with, and felt more comfortable borrowing. Or maybe she lives in the less-poor neighborhood that has attracted microcreditors. It is really hard even with fancy statistics to rule out all the stories except for the one we want to hear, about microcredit reducing poverty.

By far the most credible way to pin down cause and effect is to *randomize*, just as is done in the best drug trials in order to determine whether it is safe to put new pills in our bodies. If people who were randomly offered microfinance do better than those who were not, that's compelling evidence that microfinance helps. The first randomized studies of microfinance came out last year. The two of micro*credit* found no impact after 15–18 months on poverty indicators such as household spending and income, number of children in school, etc. But a small study of micro*savings* for market vendors in Kenya did find such benefits—among women.

This muted verdict is a far cry from the popular perception of microcredit, and, I think, the perceptions that have shaped lawmaking in the Congress.[9]

Help microfinance play to its strengths

Still, while microfinance does not live up to the hype, it has scored some impressive achievements by the standards of foreign aid. The job of those supporting microfinance, including the Congress, is to stop imposing unrealistic expectations on microfinance, and *help microfinance play to its strengths*. I would list two strengths:

- *An ability to build thriving, dynamic institutions.* The famous Grameen Bank in Bangladesh employs

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[7] "Compartamos: From Nonprofit to Profit," *BusinessWeek*, December 13, 2007, http://www.businessweek.com/magazine/content/07_52/b4064045919628.htm.

[8] E.g., Aminur Rahman, Micro-credit Initiatives for Equitable and Sustainable Development: Who Pays? *World Development* 27(1): 67–82, 1997; Lamia Karim, Demystifying Micro-Credit: The Grameen Bank, NGOs, and Neoliberalism in Bangladesh. *Cultural Dynamics* 20(5): 5–29, 2008.

[9] From Public Law 108–484, "Microenterprise Results and Accountability Act of 2004": "Microenterprise programs have been successful and should continue to empower vulnerable women in the developing world."

thousands and serves millions. Though non-profit, it is largely self-sufficient, like a business. It competes. It innovates, improving services at the bottom of the pyramid. It is hard to find such aid-fostered yet business-like institutions outside of finance. There is no Grameen Bank of vaccination. Yet the growth of such institutions is the essence of economic development.

- *The ability of such institutions to give millions of poor people more control over their financial destinies.* An excellent book, *Portfolios of the Poor,* points out that if you live on $2/day, you *don't* live on $2/day. You live on $3 one day, 50 cents the next, $2 the day after. With incomes so volatile, poor people actually need financial services *more* than we do, so they can safely put aside money on good days, or in good seasons, and draw it down in bad. Microfinance, including credit, savings, and insurance, can give people an increment of leverage over their financial circumstances—not to escape poverty, but to manage it better. The services are more interchangeable than is often realized: to pay a doctor, you can draw down savings, take a loan, or, if you're lucky, use insurance. However, among financial services, credit is not necessarily the best way to give people control over their circumstances because sometimes it does the opposite. In contrast, it is hard to imagine someone getting in trouble by *saving* too much.

For me, a compelling but achievable ideal for the microfinance project is of a growing collection of *microbanks*, thriving businesses that deemphasize credit in favor of savings. Living examples include microcreditors in Bangladesh and Indonesia, and some in which USAID has had a hand, as in Bolivia.

But a caution: The enthusiastic investment in microfinance from public and private players, billions of dollars per year, is mostly going into micro*credit*, and so to an extent is undermining the strengths of microfinance. It is causing some microfinance institutions to grow too fast, creating bubbles (a few popped last year[10]) and damaging microfinance institutions. Easy money is also dulling the impulse to do microsavings. Why should a microfinance institution go through the trouble of administering thousands or millions of small savings accounts, or lobbying for the right to do so, when easy money is on offer from the World Bank? I have argued that we need an international information-sharing mechanism such as credit bureau on *microcreditors* to track their borrowings and begin to institutionalize the idea that there is such as thing as too much credit for microcredit.[11]

Realistic Expectations of Microfinance in Haiti

Haiti has a vibrant microfinance industry. Leading institutions such as SFF and Fonkoze, actually have more savers than borrowers.[12] They appear to be good examples of microfinance playing to its strengths. American donors, public and private, deserve credit for that.

But microfinance is unlikely to fundamentally recast Haiti's private sector. It may well stimulate microenterprises, but these are by and large subsistence activities—selling vegetables, trading iron

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[10] Greg Chen, Stephen Rasmussen, and Xavier Reille. Growth and Vulnerabilities in Microfinance. Focus Note 61. Washington, DC: CGAP, 2010.

[11] http://blogs.cgdev.org/open_book/2010/03/we-need-a-public-credit-bureau-for-microcreditors.php.

[12] MixMarket, http://www.mixmarket.org/mfi/fonkoze/data/products-clients, http://www.mixmarket.org/mfi/sff/data/products-clients.

sheeting—that operate informally, below the radar of the tax man. Microfinance helps people deal with their circumstances more than rise above them.

Moreover, even counting all these savers, microfinance institutions in Haiti only reach perhaps 250,000 people, about 2.5% of the population. No doubt this number reflects years of dedication and hard work by many people. No doubt it will grow. Still, penetration will remain low for years.

So if the goal is to deliver aid to the majority of quake victims, I would not look to microfinance alone. Mobile phones and remittance networks have far more universal reach, and perhaps can be exploited to spread aid wide and fast. And I would warn against proposals (if there are any) to rapidly scale up microcredit. That could inflate a credit bubble. And it could undermine the admirable discipline of Haitian microfinance groups in taking savings.

Nevertheless, I would endorse efforts to support Haiti's microfinance institutions through this hard time. We should not let the perfect be the enemy of the good—the good in this case being assistance that helps hundreds of thousands of poor people cope with circumstances no one should have to experience. Fortunately, such efforts are already underway. They may in time include recapitalizing the institutions; assisting with transportation of cash; and supplying demand-driven technical advice, including from employees at microfinance institutions that have survived disasters in other countries.

Conclusions

To close, I highlight four priorities for supporting Haiti's private sector:

- Protect the vitality of Haiti's microfinance institutions, in part by *not* drowning them with finance that must be shoveled out the door as microloans.

- Give USAID and other agencies the flexibility to analyze and adapt to the strengths and weaknesses of the Haitian economy, procuring locally when possible, eliminating bottlenecks where possible, delivering in kind where necessary.

- To help Haitians help themselves (through the private sector), seek innovative approaches to cash delivery that exploit the money transfer and mobile phone networks, whose combined reach is vast.

- What Haitians want most is *jobs*; the best ways we have of generating those are buying more of what workers in Haiti make and allowing more Haitians to come to the United States to work.