United States General Accounting Office

GAO

Report to Congressional Requesters

February 1991

FOREIGN ASSISTANCE

AID's Implementation of Microenterprise Program Guidance

143340

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GAO/NSIAD-91-78

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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-238960

February 15, 1991

The Honorable Dennis DeConcini
United States Senate

The Honorable Benjamin Gilman
House of Representatives

The Honorable Edward Feighan
House of Representatives

In response to your request, we reviewed certain aspects of the Agency for International Development's (AID) microenterprise development program. Specifically, you asked that we determine whether (1) AID implemented congressional guidance concerning microenterprise credit assistance and (2) AID's March 1990 report to the Congress on its microenterprise development program was reasonably accurate and reliable. We performed work at AID/Washington and three missions—Guatemala, Honduras, and Senegal—and in September 1990, we testified on these matters before the House Subcommittee on International Economic Policy and Trade, Committee on Foreign Affairs.[1]

Background

AID defines a microenterprise as a business or enterprise with 10 or fewer employees. The Congress designated that at least $50 million in fiscal year 1988 and at least $75 million in each of fiscal years 1989, 1990, and 1991 be earmarked for AID's microenterprise development program.[2] The Conference Committee report accompanying the fiscal year 1988 appropriations urged that AID target up to 80 percent of these funds to people in the poorest 50 percent of the economic strata who need credit assistance to start or operate a microenterprise. The Committee report also said that special emphasis should be given to women-owned businesses and those enterprises owned and operated by the poorest 20 percent of the population. The Committee recommended that the loan size not exceed $300 unless there were indications that this amount should be exceeded to accomplish the program objectives of microenterprise development. This guidance was reemphasized by the Senate Appropriations Committee in fiscal year 1989.

[1] AID's Microenterprise Assistance Program (NSIAD/T-90-8, Sept. 26, 1990).

[2] Public Law 100-202, 101 Stat. 1329-137; Public Law 100-461, 102 Stat. 2268-5; Public Law 101-167, 103 Stat. 1202; and Public Law 101-513, 104 Stat. 1985.

Results in Brief

Prior to the 1988 legislation, AID did not have an overall policy for structuring microenterprise activities. In October 1988, AID issued and distributed to its overseas missions a Policy Determination that incorporated the congressional guidance, but did not make it mandatory. AID's policy allowed missions considerable flexibility in assisting microenterprises, and accordingly, the missions we visited did not specifically target their microenterprise projects to the poorest 50 percent of the population or emphasize credit assistance to women or the poorest 20 percent of the population. Also, loans frequently exceeded $300 because this loan size was considered too low for the country's economic circumstances. AID has recently taken steps to improve its management and oversight of its microenterprise development programs by consolidating responsibility within the Office of Small, Micro and Informal Enterprise.

The data in AID's March 1990 report to the Congress was of questionable validity. AID did not have a system to track detailed information concerning its microenterprise credit activities. At the three missions we visited, which represented about 27 percent of AID's microenterprise loans for 1989, we found that much of the specific data concerning loan size and the recipient's gender and economic status was based on estimates. The lack of specific information was not noted in AID's report, and consequently, the report leaves the impression that the data was more precise than is the case. AID has initiated an effort to keep track of this information; AID estimates it will have a fully operational information system for the microenterprise program by 1992.

AID's Response to the Congressional Guidance

In response to the fiscal year 1988 Appropriations Conference Committee Report, the AID Administrator appointed an Advisory Committee[3] in February 1988 to assist AID in developing guidelines for AID's microenterprise development program. This guidance resulted in AID's first overall policy for structuring microenterprise activities and directing resources in support of them.[4] While the congressional guidance provided in the 1988 conference committee report was not mandatory, AID included much of the guidance, such as the suggested loan size and recipient gender and economic status, in the Policy Determination. It was issued to AID's missions in October 1988.

[3]It was composed of individuals from the U.S. private sector, including nongovernmental organizations who had experience in implementing microenterprise projects in developing countries.

[4]AID Policy Determination-17 (PD-17), Microenterprise Development Program Guidelines.

In addition, in February 1990, AID established the Office of Small, Micro and Informal Enterprise within what is now the Bureau for Asia and Private Enterprise.[5] The Office has responsibility for coordinating AID's microenterprise development program. According to AID officials, this Office was established to ensure more effective control over program implementation and resources. Previously, AID's Bureaus for Policy and Program Coordination and Science and Technology had joint responsibility for coordinating the microenterprise program. However, consistent with AID's overall structure, the responsibility for implementing individual projects remains with the various field missions, bureaus, and offices initiating them.

Implementation of AID's Microenterprise Guidance

AID's microenterprise guidance gives mission officials the flexibility to adapt their microenterprise development program to specific country conditions. Therefore, AID's missions use a variety of activities to assist microenterprises, including training and technical assistance, institutional support, policy and regulatory reform, and credit.

We visited Guatemala, Honduras, and Senegal and found that all three missions used the full range of available approaches in supporting microenterprises. For example, the Guatemalan government, using AID funding, has implemented a project to increase the productivity and income of microenterprises and to generate employment. Its goal is to provide credit, technical assistance, and training to 20,000 microenterprises.

In addition, all three missions supported small credit associations, such as village banks, cooperatives, credit unions, and solidarity groups. These projects typically used the "group loan methodology," which employs group pressure to encourage loan repayment. Loans disbursed through these organizations ranged from about $45 to almost $1,200 per individual.

We also found that all three missions used intermediary organizations—private voluntary organizations (PVO) and nongovernment organizations (NGO)—to design and carry out their microenterprise projects. However, the degree to which these organizations used "grassroots," or local community-based groups varied by country. In Guatemala, for example,

[5]On October 1, 1990, the AID Administrator added responsibility for Asia to the Bureau for Private Enterprise and renamed the Bureau. Asia had previously been part of the Bureau for Asia, Near East, and Europe.

the majority of PVOs worked directly with the project beneficiaries. In contrast, a microenterprise project in Senegal provided funding to eight local community organizations and one PVO to provide credit, as well as literacy and numeracy training, directly to 57 village organizations.

The $300 Loan Size Guidance

In recent hearings on AID's microenterprise program, congressional members and a PVO official suggested that the $300 loan size helps ensure that loan recipients are truly the poorest of the poor. According to these officials, this is because persons in higher economic strata need larger loans to improve their situation. Some suggested that the loan size should be legislatively mandated and that a specific amount should be earmarked for this purpose.

This approach differs from the position of AID's Advisory Committee and most AID officials we interviewed. In April 1990, AID's Advisory Committee recommended that the suggested loan size of $300 be removed from the AID Policy Determination. The Committee considered the $300 loan size inappropriate for many countries and that other programs can more directly help the poorest of the poor.

AID officials stated that $300 loans may be appropriate as start-up loans, but that this amount is inadequate to meet the needs of expanding microenterprises. According to mission officials in Guatemala and Honduras, a $300 loan is sufficient to provide working capital for getting a microenterprise started; but in Senegal, AID officials said that because of the cost of materials and supplies a $300 loan size is too low in most instances. All three missions noted, however, that larger size loans ($350 to $2,100) were needed to assist microenterprises that do not qualify for loans from commercial banks. Basically, all agreed that the loan size should be determined by the credit needs of the target beneficiaries.

Targeting the Poorest of the Poor

None of the three missions we visited targeted their microenterprise projects specifically to women or the poorest 20 percent of the population. However, according to some PVO officials, these people were benefiting from their projects. According to AID, PVO programs serve very small entrepreneurs, the vast majority of which are single owner and operator enterprises with few, if any, other options for credit or technical assistance. PVO officials also said that they did not have the financial and management capacity to target the poorest of the poor, especially if they are living in rural, inaccessible areas. According to

these officials, this group might be better served by social services that address problems of health care, nutrition, or literacy.

In commenting on this report, AID stated that its estimates and discussions with PVOs indicate that beneficiaries of AID-supported microenterprise programs are indeed quite poor. AID acknowledged, however, that accurate data was not available and that proxies are used as a substitute for direct poverty measurements. AID believes that it would be impractical to design programs based on stratifying the poor into fine classifications. AID added that accurate reporting on the incomes of beneficiaries may not be feasible, would be extremely costly under any circumstances, and could not be pursued without sacrificing the principles of effective service delivery to the poor.

AID's Report to the Congress on Its Microenterprise Development Program

In 1988 and 1989, several Members of the Congress requested that AID provide specific data to document that it was devoting the earmarked amounts to the microenterprise program and providing $300 (or less) loans to the groups targeted in the congressional guidance. AID stated that it had complied with the law; however, it stated that the specific data concerning loan size and recipient gender and economic status were not readily available and would be difficult to compile.

Nevertheless, in February 1990, AID sent a questionnaire to its missions requesting detailed information on their microenterprise development activities. For credit activities, information on loan size and recipient gender and economic status was requested. AID issued a report to the Congress on the program in March 1990.[6]

The report presents statistics from 47 missions reporting microenterprise projects for 3 fiscal years—1988, 1989, and 1990. AID reported that it had funded about $140 million in all types of microenterprise activities in fiscal years 1988 and 1989, with an additional $83 million estimated for fiscal year 1990. In addition to credit assistance, AID included technical assistance and training, institutional support, and policy and regulatory reform. These activities are consistent with AID's definition of its microenterprise development program. For microenterprise credit activities (including all credit projects—not just ones with loans of $300 or less), AID reported $18.4 million in fiscal year 1988, $30.3 million in 1989, and $36.4 million in 1990.

[6]Report to the Congress, AID Microenterprise Development Program (Mar. 30, 1990).

Mission Data Is Questionable

In analyzing AID's report to the Congress we examined the data and supporting documents for three of AID's missions—Guatemala, Honduras, and Senegal—for fiscal year 1989. These three missions accounted for about 27 percent of the $30.3 million for microenterprise loans in fiscal year 1989.[7]

We found that none of the three missions we visited had a system to reliably and accurately obtain the data requested on short notice by AID/Washington's questionnaire. We found supporting documents at the missions for amounts obligated for microenterprise projects, but most of the other data on loan size and beneficiary characteristics had to be obtained from PVOs or NGOs implementing the projects. However, these groups did not routinely keep track of these data, nor were they required to do so by AID. Also, in some cases, they were not able to provide data by U.S. government fiscal year because their accounting systems were on a different fiscal year basis. Therefore, much of the specific data needed to reply to the questionnaire was not readily available.

We found problems with the data reported by each of the three missions we visited. These missions reported a total of 17 microenterprise loan projects (out of a total of 170 reported by AID)—six each in Guatemala and Honduras and five in Senegal.

- One project reported by each mission for fiscal year 1989 was not funded that year and should not have been included in AID's report.
- In Guatemala, the mission understated the funds obligated to three microenterprise projects by a total of about $700,000 and overestimated the percentage of loans directed to women on one project.
- In Honduras, for one large microenterprise project, the amount of loans funded with local currency was understated by about $400,000, the amount of all loans made was understated by about $600,000, and the number of loans was understated by nearly 700 (out of about 6,600).
- For Senegal, the average loan size AID reported to the Congress for one microenterprise project was not consistent with data submitted by the mission. AID reported $130 as the average amount; but using the method described in the mission's response the average would be about $475. We were told that adjustments had been made to account for numerous

[7]The top eight countries reporting microenterprise loan projects were El Salvador with $5.5 million, Senegal with $3.3 million, Guatemala with $3.2 million, Indonesia with $2.4, Madagascar with $2.1 million, Jamaica with $2 million, the Philippines with $1.8 million, and Honduras with $1.6 million.

small loans to village groups over several years. However, the adjustments were not documented, and we could not validate the calculation.

Our review of mission documents and discussions with cognizant mission officials showed that the data reported by AID in March 1990 is of questionable validity. AID did not have an information system for collecting and reporting data on the microenterprise program and much of the data reported by the three missions was based on assumptions or estimates. Each of the three missions we visited, which collectively represented 27 percent of microenterprise loans for 1989, had significant reporting problems. Furthermore, an AID official acknowledged that about 30 percent of all missions responding to the questionnaire did not answer questions regarding loan size or gender and economic status of loan recipients. These limitations in the data were not cited in AID's report to the Congress and, therefore, the report leaves the impression that the data was based on more precise information than was the case.

Efforts to Establish an Information System for Microenterprise Loan Data

AID is taking steps to establish an information system for better oversight of its microenterprise development program. AID contracted with the firm that tabulated the data for the March 1990 report to determine whether a system could be designed to track AID's microenterprise credit assistance projects and produce the type of information requested by the Congress.

A draft feasibility study was submitted to AID in July 1990. AID's contractor concludes that such a system is feasible. The contractor proposes to use data and reporting structures that should already be in place at the project implementation level. However, as noted in the study, a number of matters need to be resolved before the system can be implemented. These include the following:

- How can AID-provided funds be separately identified when PVOs and NGOs have multiple funding sources and funds are commingled?
- How should fluctuating or multiple exchange rates be treated?
- What criteria or parameters should be used or developed to establish income percentiles and poverty levels?
- How should non-financial microenterprise activities and their contributions be accounted for?

An AID official estimates that setting up such a system worldwide will cost about $300,000 to $400,000 a year for the first several years. AID is initiating a pilot test involving three African countries to validate the

cost estimates and determine whether a worldwide information system is feasible. Depending on the results, AID plans to begin development of a worldwide information system that it expects will be generating data early in 1991 with a fully operational system in place by 1992.

Because of the actions AID is taking, we are not making any recommendations at this time on establishing a new information system to track AID's microenterprise development program. Also, as part of an ongoing review, we are evaluating the need for and effectiveness of AID's 80-plus financial and management information systems.

Scope and Methodology

We reviewed the applicable legislation and committee reports and AID documents concerning the microenterprise development program. We discussed the program with cognizant officials in Washington, D.C., and at the AID missions in Senegal, Guatemala, and Honduras. We also reviewed microenterprise project files, including support for the missions' replies to the AID questionnaire and documents on the scope and objectives of the project, and discussed related matters with relevant PVO, NGO, and local grassroots organizations in the three countries we visited. We focused on AID's microenterprise credit activities for fiscal year 1989, which was the most recently completed fiscal year.

We conducted our review between January and December 1990 in accordance with generally accepted government auditing standards.

Agency Comments

AID generally concurred with the report. It stated that the report makes a balanced presentation of the program and the difficulties inherent in collecting and reporting reliable data on microenterprise activities overseas. AID said it would ensure that its future reporting include discussions of data sources and reliability. AID also made several comments to help clarify its position on various topics covered in the report and to correct and update certain information. (See app. I.) We have incorporated these comments into the report where appropriate.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of the report. At that time, we will send copies to the Secretary of State; the Administrator of AID; the Director, Office of Management and Budget; cognizant congressional committees; and other interested parties. The major contributors to this report were A. H. Huntington, III, Assistant Director;

Norman T. Thorpe, Evaluator-in-Charge; and Olivia L. Parker, Evaluator. Please contact me at (202) 275-5790, if you or your staff have any further questions.

Harold J. Johnson
Director, Foreign Economic
Assistance Issues

Comments From the Agency for International Development

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ASSISTANT
ADMINISTRATOR

JAN 11 1991

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Conahan:

Reference: FOREIGN ASSISTANCE: AID's Implementation of Microenterprise Program Guidance (code 472208)

Enclosed is the Agency for International Development's response to the subject draft report. It is my understanding that these comments will be incorporated into the section at the end of the draft report which anticipates "Agency Comments". If you have any questions, or need further clarification regarding this response, please contact Michael Farbman, Office of Small, Micro and Informal Enterprise, at (202) 647-2727.

Sincerely,

Henrietta Fore
Assistant Administrator
Bureau for Asia and Private
Enterprise

Enclosure: a/s

RESPONSE TO THE GAO AUDIT OF
A.I.D. MICROENTERPRISE DEVELOPMENT ACTIVITIES

A.I.D. is pleased with the overall findings of the General Accounting Office's audit of the Agency's microenterprise development program and with the professional manner in which the exercise was carried out. The audit report makes a balanced presentation of the Agency's program and demonstrates an understanding of the difficulties inherent in collecting and reporting reliable data on microenterprise activities in the field.

The GAO audit team educated itself quickly and effectively to the subject matter and was assiduous in reading the basic microenterprise literature. Furthermore, the team visited several field projects and became familiar with the on-the-ground challenges in doing microenterprise work. Those A.I.D. staff who worked with the audit team found them to be fair-minded and open to discussion of the various sector issues.

Although there are no recommendations in the audit report to which A.I.D. must specifically respond, a few comments follow that attempt to make clear A.I.D.'s position on various topics that are covered in the audit report.

COMMITMENT TO HELPING THE POOR

A.I.D. believes that microenterprise development offers many developmental benefits, not least of which is its ability to help the poor with their economic activities. Congressional report language, referred to in the audit report on page 2, is written as if it presumes that A.I.D. is not committed to this purpose. Quite the opposite is true. Indeed, most senior A.I.D. staff have direct experience with development at the level of microenterprises, emanating in part from the "New Directions" legislation of the early 1970's which emphasized grass roots, bottom-up development programming. This commitment is reflected in the Agency's current portfolio of microenterprise programs, which are focused on the smallest of income-generating activities, and it is reflected in a range of other Agency programs, from food security to child survival. The recent emphasis on private sector development has been translated, therefore, into wide Agency support today for microenterprise development programming. A.I.D. is perceived by international PVOs and other donors as a leader in the promotion of microenterprise and micro-lending activities. It is ironic that A.I.D. -- which undertook the classic research (PISCES) demonstrating the viability of micro-lending projects and underscoring the importance of such projects in serving the poor -- should now have to persuade others that it supports such programs.

QUALITY OF A.I.D.'S DATA ON MICROENTERPRISE ACTIVITIES

Now on pp. 5-7.

The central concern of the audit report is the quality and reliability of A.I.D.'s reporting to Congress on its microenterprise activities (pages 10-13). The report is generally fair in describing the quality of that reporting. It acknowledges the difficulties inherent in collecting data on a heterogeneous mix of programs in nearly 50 countries, and notes that the March 1990 report was a first attempt in what will need to be an ongoing process of improving such data. As GAO stated, A.I.D. should indeed have been more forthcoming about the fact that much of the data in that report were based on estimates, rather than hard figures. A.I.D. will ensure that future reporting includes discussion of data sources and reliability.

THE $300 LOAN SIZE GUIDANCE

Now on p. 4.

The audit report's discussion of the loan size issue (pages 7-8) accurately reflects A.I.D.'s position. Based on years of practical experience in supporting microenterprise programs, A.I.D. has seen that a limit of $300 -- or any other specific, unvarying loan size limit -- is not an effective way of ensuring that loans reach the very poor, for a number of reasons. First, appropriate loan sizes vary with economic circumstances in each country, particularly personal income levels and costs of materials and supplies. Second, both for their own viability and for serving the large numbers of diverse microenterprises with no alternative source of finance, institutions may need to offer a larger mix of loan sizes. Third, and perhaps most important, imposing a U.S. dollar-based, fixed ceiling on loans made by indigenous programs in developing countries violates the principle of local and community determination which has proven so effective in working with the poorest groups. It is a top-down imposition in an area where bottom-up decision-making is most important. As GAO's report notes, A.I.D.'s Advisory Committee on Microenterprise unanimously supported removal of references to the $300 loan size in A.I.D.'s policy guidance. What is more, A.I.D. knows that a majority of organizations actually serving microenterprises -- both U.S. PVOs and local NGOs -- concur.

TARGETING THE POOREST OF THE POOR

Now on pp. 4-5.

Some clarification is needed in the GAO report's discussion of targeting to the very poorest people (pages 8-9). The report questions whether microenterprise assistance, particularly credit programs, reach the most extremely poor people. Estimates compiled by A.I.D. missions and discussions with PVO practitioners indicate that beneficiaries of A.I.D.-supported microenterprise programs are indeed quite poor. Most of the enterprises consist of one person, or of two or three family-members working together. The nature of typical activities -- street vending, food processing at a rudimentary level, and

tailoring or other simple manufacturing -- suggests that the clients are clearly members of poor segments of the population. However, whether these people include the most extreme cases of poverty is a question that can be definitively answered only through research comparing program beneficiaries and the poorest citizens of their countries. In A.I.D.'s view, it is impractical to design programs based on stratifying the poor into fine classifications, and such classification can be harmful to the dignity of the beneficiaries.

Rather, A.I.D. believes that targeting may be done most cost-effectively by applying simple proxies specific to the program setting, such as landlessness or residence in poverty-stricken slums. These proxies substitute for an income test or other direct poverty measure. Successful credit programs for the poor use very simple application processes so that informal and illiterate clients will gain the courage to approach them. Inclusion of a "means test" to determine income in a way that would allow for statistically valid worldwide reporting would undermine this user-friendly face. In short, accurate reporting on the incomes of beneficiaries may not be feasible, would be extremely costly under any circumstances, and could not be pursued without sacrificing the principles of effective service delivery to the very poor.

MONITORING SYSTEM FOR MICROENTERPRISE DATA

As noted in the report, A.I.D. is in the process of designing and testing a monitoring system on microenterprise programs, which will ensure that the quality of the data improves steadily in the coming years. The system should become operational for end-of-year reporting on fiscal year 1991, though additional months of testing the system will be necessary before full reliability of data is achieved. For a highly streamlined data collection effort, costs are unlikely to be as high as those quoted in the GAO report. Current estimates are well under $500,000.

SPECIFIC ITEMS IN THE REPORT

Two minor corrections to the report follow:

Now on p. 2.

- Page 4, lines 10-14. The Advisory Committee reviewed and commented on drafts of A.I.D.'s policy guidelines on microenterprise development, but the guidelines themselves, Policy Determination No. 17, were issued by A.I.D.

Now on p. 3.

- Page 5, line 2. The new Office of Small, Micro and Informal Enterprise is responsible for coordinating the Agency's microenterprise development program, but implementation of the program is carried out by various field missions and offices of the Agency.

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