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Mr. Chairman, and Members of the Subcommittee:

Thank you very much for the invitation to testify at today's hearing on a very important international development topic: the current state of microfinance and, going forward, the appropriate roles and mix of public and private funding.

Small loans are now big news, having produced a Nobel Prize winner and helped millions of microentrepreneurs expand their business opportunities, create jobs, and improve living conditions for their own families and the communities where they live.

Once the altruistic domain of NGOs and their sponsors, microfinance is now a tested business model that can offer a variety of financial products including working capital loans, savings accounts, remittance transfers, payment services, microinsurance, and even housing finance.

But for all its evident success, microfinance is at a crossroads. For almost four decades, different models of microfinance have been tested, vetted, and implemented around the world. Although microfinance began in Bangladesh and Brazil in 1972, it is still reaching less than 10% of its potential market of at least one billion entrepreneurs around the world.

In that effort we have learned what works and what doesn't. For example, nothing works without supportive legal and regulatory environments; NGOs continue to play a leading and important role in developing new approaches but often need more professional management to expand operations; and the appropriate role of limited public resources is to go where others won't – not where they will.

It is the role of multilateral, bilateral and other public finance to provide the necessary resources to test various models that have the capacity, if successful, to be replicated (and leveraged) so that a program can eventually reach sustainability and scale. In my opinion, no other development model provides the opportunity for leveraged impact as microfinance.

Let me outline the activities of the Multilateral Investment Fund (MIF) in promoting microfinance as a way to illustrate these points, and also provide the perspective of the donor community at today's hearing.

When the MIF began in 1993, as primarily a grant instrument, there were approximately 400 NGOs and one regulated financial institution providing microcredit to about 500,000 clients throughout the Western Hemisphere. Today microfinance in Latin America and the Caribbean is provided through a network of over 600 organizations reaching about 12 million clients, including 200 regulated institutions, which provide about 80% of the financing.

This growth occurred principally because of the pioneering work of several NGOs which were able to transform themselves into regulated institutions which, in turn, could then take deposits and lend a multiple of their assets, subject to strict oversight and control.

As this transformation unfolded, microfinance became the fastest growing, least risky, and most profitable sector of Latin American finance, attracting private sector attention and, eventually, private investment. The key role of the MIF in this process was to:

1. focus on improving legal/regulatory environments for microfinance
2. provide grant financing to strengthen the capacity of NGOs to transform into regulated institutions
3. invest through debt/equity in leading microfinance institutions to test the model

4. sell microfinance investments to the private sector as soon as appropriate.

Once the microfinance model is tested in a country, and institutions are commercially sustainable, it is time for the public sector to exit those investments and move on to other frontiers. For example, MIF began by investing directly in several institutions, but also set up the first microfinance investment fund in the world, which began operations in 1995. Today there are 75 such investment vehicles, which have committed more than $2 billion to microfinance institutions worldwide. After Hurricane Mitch devastated large parts of Nicaragua and Honduras, MIF helped establish an Emergency Liquidity Fund (ELF) which provides bridge financing to sound microfinance institutions dealing with the aftermath of natural disasters or financial crises in their countries.

Other MIF accomplishments include:

- the world's first microfinance guarantee fund (LACIF)
- the first local currency fund (LOCFUND) to deal with the risk of dollar-denominated lending
- extensive programs linking remittances to microfinance institutions
- developing a rating system to compare microfinance environments around the world, now covering over 100 countries.

From 1993 through 2009, MIF committed $282 million to microfinance programs; including $127 million (45%) in loans, $102 million (36%) in equity, and $53 million (19%) in grants. The repayment rate on loans is 99.78%, and return on equity investments average around 10% (the only losses involved devaluations of local currencies). Because of this positive track record, MIF investment funds have attracted over 100 private sector and 15 public sector partners, leveraging MIF commitments by more than 3-to-1. Finally MIF grants have been critical in establishing a network of strong institutions and highly regarded local microfinance management teams throughout the region. As a result, 6 Latin American countries currently rank in the top 10 out of 100 worldwide as places that provide positive environments for the development of microfinance markets.

In conclusion, microfinance works – we know how to do it in a commercially sustainable way, which can attract private investment in partnership with public sector financing which focuses on mitigating initial risks and which can reach the scale necessary to truly make a difference.

Now is the time to build a finance system that can reach the majority, and provide the working poor entrepreneurs of the world with more options to use their resources, energies, and talents. They will do the rest…

I would like to mention two other items, which may be of interest. First, there are five leading MFIs in Haiti that were reaching about 140,000 clients two weeks ago. Although there will be some emergency assistance, the ability to repay many of the outstanding microfinance loans in Haiti also lies in the rubble given the scale of the disaster. The MIF is developing a program to save microfinance in Haiti, and then to rebuild it as an engine of growth for the economy. The goal is to double the impact of microfinance by 2015 to 300,000 Haitian families. It is a project worthy of the support and partnership of the private sector as well.

Second, I am currently teaching a course at Boston University Law School on development finance that is attracting graduate students from Law, Business, and International Development Schools. Interest in microfinance far exceeds the current offerings in graduate schools across the United States, where it is largely located in Public Policy programs. Broadening graduate school programs is one important way to improve the “financial literacy” at the top of the economic pyramid. This is one model of “trickle down economics” that deserves widespread support.