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# FINANCE for the POOR

## SHARING INFORMATION ON MICROFINANCE

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**I** am pleased to write this message for the Third Anniversary Issue of the Asian Development Bank's (ADB) quarterly microfinance newsletter, *Finance for the Poor*.

Three years ago, ADB formulated a **Microfinance Development Strategy (MDS)**. The MDS outlined a series of measures that ADB would take to improve the quality and quantity of assistance that it will provide to develop the microfinance industry in the Asia and the Pacific region.

*Finance for the Poor* was introduced as one such measure. The first issue of this newsletter was released in July 2000 by the Focal Point for Microfinance, with a view to providing information on microfinance not only for ADB's own staff but also for a wider community consisting of policy makers, practitioners, and

researchers in its developing member countries. Over time, its readership has grown to include those in developing countries in other regions, developed countries and microfinance staff in other funding agencies. Both its print and web versions are sought by an increasing number of readers because of its high quality and the focus on issues at the cutting edge of microfinance development.

I congratulate the Focal Point for Microfinance, particularly Nimal Fernando, the editor of the newsletter, for taking the initiative and continuing this publication uninterrupted for 3 years. Many newsletters have come and gone. But the *Finance for the Poor* has stayed. It will, in my view, stay for many more years as a sought-after source of information on the microfinance industry.



# BUILDING FINANCIAL SERVICES FOR THE POOR

BY ELIZABETH LITTLEFIELD  
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## Introduction

About a billion people lack access to convenient, affordable, and appropriate financial services. The Microcredit Summit estimates that microfinance institutions (MFIs) deliver microcredit to 38 million poor people and savings-deposit services to 65 million. While the figures are staggering, the market penetration is still insignificant, compared with the large number of poor and low-income households that need financial services. Moreover, growth is very slow; microcredit outreach has increased by only around 4% among institutions that have been reporting to the Microcredit Summit for the past several years. The urgent need is to remove barriers and thereby scale-up more rapidly promising microfinance institutions. To reach the hundreds of millions of people who need financial services, other delivery channels that can complement MFIs must also be identified. The ultimate aim of expanding microfinance outreach is to reduce the vulnerability of the poor by helping them increase incomes, build assets, and chart their own paths out of poverty—with self-respect, self-determination, and sustainability.

The microfinance industry has talked, for years, about scaling up. The starting point is to have a vision that every poor country's financial system works for the majority—the poor. The Economist and the International Labour Organization cite that nearly 60% of Latin America's and two thirds of Africa's nonagricultural employment are in the informal sector. In India, 9 out of 10 workers are in the informal sector, contributing 60% of net domestic product and 70% of income. Scaling up microfinance means looking beyond the status quo of a financial system that

caters only to a minority of the population while the majority remains unserved. It will require repositioning financial services for the poor as a far more significant business than it has been perceived, operating not on the margins of the formal financial systems or as a specialty niche within them—but being at the core. Virtually in all developing countries, the collective productivity of the poor is the core of countries' wealth, employment, and labor.

Throughout the 1980s and 1990s, microcredit bucked conventional wisdom about financing the poor. First, MFIs showed that poor people, especially poor women, repay their loans. Near perfect repayment rates were common among the better programs—unheard of in most formal financial sectors and in the many failed subsidized credit schemes of the 1970s. Second, the poor were willing and able to pay interest rates that allowed MFIs to cover their costs, and even to profit. Third, these two features—high repayment and cost-recovering interest rates—permitted well-managed MFIs to achieve long-term sustainability and to reach large numbers of clients. As a strategy combining massive outreach, far-reaching impact, and financial sustainability, microfinance is unique among development interventions.

## From Microcredit to Microfinance

The microfinance community, however, later began to note several inherent limitations in the microcredit model.

- Not all poor people ran microenterprises. Supply-driven microenterprise credit methodologies reached a relatively narrow band of clients, leaving behind a range of poor

people for whom credit products are not particularly suited.

- The financial services needed by the poor covered not only working capital loans but also credit for other purposes, insurance, and money transfer services. Convenient and secure deposit services were also crucially needed.
- While vital for conducting research and development of new models, nongovernment organizations (NGOs) face serious challenges in governance, legal frameworks, and cost structures. Many remain dependent on donor subsidies.
- Institutions with large existing infrastructures—commercial and state-owned banks, credit union networks, financial cooperatives, and even retail chains—began providing financial services to the poor, although motives, fair pricing, service quality, and sustainability varied. The urgent need for a far broader range of flexible, convenient, and affordable financial services for the poor can be addressed by strengthening and scaling up high potential MFIs and encouraging a range of complementary institutional models.

## Multiple Approaches

For microfinance to reach more poor households, many more organizations need to join forces and learn from the MFIs, spread out, and each cover their own market niches. Different countries will need various combinations of financial service providers. Countries with sophisticated financial infrastructure will have different options from countries without. Sparsely populated agriculture-dominated areas will need approaches different from densely populated trading communities. Some organizational models may be best suited for urban areas, others for rural areas. Some may concentrate on the very poor, others on the growing needs of less-poor microenterprises. No one approach is inherently better or more worthy than another. A range of complementary or even competing approaches must be encouraged to deliver financial services to the poor. In

many cases, the organizations already exist, but need to be better understood and connected to each other and to MFIs.

State-owned banks in most countries have had a dismal record; many were wasteful and corrupt banks, which bore testimony to the failure of state intervention. But with their vast infrastructure and with their transfer to the private sector for more efficient and transparent management, these banks can deliver financial services to the poor on a scale far bigger than can be attained from building an MFI branch by branch. Some large private commercial banks with significant branch networks are seeing new, low-risk market opportunities in serving the poor as the competition in their other market segments increases, or seeking to leverage underutilized branch infrastructures. Even in Latin America, with its rich history of microenterprise finance, more people below the poverty line in some countries receive more financial services from consumer credit companies than from all MFIs and banks combined. These organizations, along with the others throughout the developing world which have been providing financial resources for the poor before the term microfinance was coined, have much to teach and learn from the microfinance industry. While there are clear dangers, as the well-known recent history in Bolivia showed so well, these organizations can be encouraged in some cases to adopt fair and transparent pricing and practices, thus harnessing their power for the benefit of the poor.

Existing nonfinancial infrastructure in poor people's villages and towns may serve as a vehicle for delivering financial services to the poor. They may deliver financial services not only more widely and quickly but also more cost effectively to poorer people. The South African social payments system uses a fleet of more than 8,000 armored trucks and cars to deliver grant money (child grants and pensions, among others) monthly to almost 5.5 million South Africans, moving from village to village, using thumbprint recognition to verify identities. Such existing infrastructure may be adapted to

deliver a broader range of financial services on a very large scale. Another example of a nonfinancial infrastructure where financial services might be layered is the network of 800,000 long-distance telephone booths in rural and urban India, all staffed and connected by a central information system. Work is underway to experiment with building financial services into this vast network. Another infrastructure that could be tapped are the brightly painted kiosks along the dirt roads of rural Haiti, located every mile or two, where villagers can buy tickets for the lotteries in the United States and the Dominican Republic. Using creativity in nonfinancial infrastructure networks and working effectively in partnership with them are steps toward reaching more people faster than concentrating only on the MFI model.

Informal systems like moneylenders, savings clubs, rotating savings and credit associations, and mutual insurance societies are pervasive in nearly every developing country and are often overlooked as an important service provider to the poor. Some informal organizations may provide large-scale outreach if linked with other systems and managed with transparency and fair pricing. As a recent article in the Asian Development Bank (ADB) Finance for the Poor quarterly newsletter (Fernando, March 2003) pointed out, even the typically maligned pawning industry delivers financial services to the poor in ways, which are not necessarily exploitative but are of value to their customers. Another scheme is taken by suppliers or commercial vendors, who provide fertilizer and other inputs on credit. In El Salvador, for example, of the 50% of the rural population with access to credit, more than half of that comes from nonfinancial institutions such as suppliers.

Informal and some formal financial services currently available to the poor, however, have serious limitations in terms of cost, risk, and convenience. Moneylenders, for example, charge exorbitant interest rates on loans and typically do not scruple to strip a family of its last assets in case of repayment difficulty. Buying seeds or fertilizer on credit is far more expensive than paying cash. Local

rotating savings and credit associations often allow deposits and loans only at very specific time intervals and limited amounts. If the experience of the leading MFIs has demonstrated conclusively that the working poor are viable customers for financial services, it is unfortunate that they remain underserved. With access to financial services, the working poor stand a fighting chance of escaping poverty and improving their living conditions. Those who do not have access are most likely to remain trapped in poverty.

The global development community has begun to recognize the multidimensional nature of poverty and the importance of individual choice and empowerment in the lives of the poor. Last year, the international development community rallied around the Millennium Development Goals (MDGs), which set forth quantifiable objectives for reducing the worst aspects of poverty—hunger, disease, lack of education, women's oppression, and child mortality and morbidity—by 2015. The MDGs can propel the microfinance industry, too, as more people begin to realize that access to financial services underpins the ability of the poor to accomplish all these goals. The evidence from the MFI experience has clearly shown, over time and across cultures, that with access to appropriate and affordable financial services, many of the poor's other problems begin to take care of themselves. Evidence from development work generally supports the basic proposition that permanent, systemic change comes about when people create their own solutions—people simply place greater value on that which they do for themselves.

Integrating microfinance into the established financial sector and deploying more delivery channels will require patient and creative experimentation with different models, mechanisms, products, and services. It will need generous, timely, and effective information sharing about failures and successes. It will have to strengthen successful microfinance institutions and adopt higher and more consistent reporting standards, particularly greater transparency, on the financial strength and performance of microfinance operations.

## Blurred Borders

To many players in microfinance and outside this field, it is intimidating to blur the borders around the industry and to merge into the world of banking, technology, and financial systems. For many, this threatens expertise and tends to narrow the field. But it is essential to start recognizing that the poor are not mere clients of the development community, but citizens of their countries, with rights to benefit from a financial system that serves their complex needs. If clients' needs are the primary concern, set above those of institutions and politicians, poor countries can have democratic financial systems that serve the majority of their citizens—the poor, within a reasonable period.

### Role of the Consultative Group to Assist the Poor

The mission of the Consultative Group to Assist the Poor (CGAP) is to help build financial systems in poor countries that serve their majority—the poor. CGAP is a consortium of donors, working together with service providers and financial institutions to set standards for the industry, promote transparency, and act as a resource center, service provider, and catalyst for innovation.<sup>1</sup> Through its 29 donor-member shareholders, including ADB, CGAP develops and distributes technical guidelines, handbooks, and research findings; and provides strategic advice, technical support, and training to microfinance managers, donors, and policymakers. CGAP also develops new initiatives and innovates. CGAP recently adopted a 5-year strategic plan (CGAP, January 2003) focusing on four major areas for helping create financial systems for the poor.

### Promoting Institutional Diversity

Reaching a billion poor people with microfinance services will require many different types of financial intermediaries and other delivery mechanisms, each focusing on a market

segment within the country: sophisticated financial architecture and the less developed; the rural and the urban; the agricultural worker and the trader; and the consumer and the producer. CGAP is experimenting with partners to provide financial services on a large scale—commercially and rapidly. CGAP provides advice, training, evaluation frameworks, and funding to several different types of delivery mechanisms, from rural credit unions to urban nonfinancial delivery channels.

One example is CGAP's partnership with the Africa International Financial Holdings, which has raised funds from investors such as the Hongkong and Shanghai Banking Corporation to bid on 7-9 state banks, being auctioned in Sub Saharan Africa, that have large branch networks, mainly in rural areas. The aim is to retain the branch networks, turn the banks around, and develop retail banking services for the poor as a core business. CGAP serves as the technical partner that will develop microfinance products through the networks and train local staff to implement the services.

### Promoting Diverse Financial Services to a Broad Range of Clients

Poor clients need various financial services; and credit is not necessarily the most urgent or appropriate service in all cases. The poor and extremely poor need and will pay for deposit services, money transfers from urban markets to rural families, crop and health insurance, to name a few. CGAP has several programs to foster the development of services that address the needs of poorer clients. CGAP, for instance, provides guidance in situations, where grants are more appropriate than financial services, particularly for clients without any source of income. There are few, but potent, examples of programs that graduate the destitute to use credit effectively. The Bangladesh Rural Advancement Committee's Income Generation for Vulnerable Groups Development Program is one of these programs, with over a million women successfully graduated from undertaking safety net, feeding

programs to using loans productively (CGAP, May 2001). CGAP's plan is to document such models and provide guidance on whether alternatives to microcredit are a better intervention than financial services.

### Improving Information Quality and Availability

The availability of reliable, widespread, and comparable data on the financial performance of financial institutions serving the poor is an absolute precondition to developing large-scale commercial microfinance. Since the objective is to create financial intermediaries, these intermediaries must demonstrate their financial soundness before they become eligible for local bank lending or are entrusted with poor people's savings. Promoting financial transparency in microfinance is a cornerstone of CGAP's work. CGAP provides technical tools and services all along the information chain, from management information systems to audits, performance evaluations, ratings, performance benchmarking, and supervision. One example is the Microfinance Information Exchange (MIX), developed by CGAP over several years and spun off into a new independent organization in 2002. The MIX collects, verifies, and reports on financial data of over 100 microfinance institutions in a searchable and sortable database. Increasingly the MIX is seen as a potent reporting tool, enabling MFIs and donors to report and collect data in one central database.

### Fostering a Sound Policy and Legal Framework

The appropriate role of governments in creating financial services for the poor is as a facilitator, rather than a direct service provider. Governments can either undermine or encourage the development of microfinance. CGAP provides international and country-level policy consultations on appropriate regulation and supervision for microfinance and guidelines on appropriate policy approaches. CGAP has developed, along with its 29 donor members and many experts and central bankers, the Consensus Guidelines for

<sup>1</sup> More information on CGAP can be obtained from <http://www.cgap.org>

the Regulation and Supervision of Microfinance (CGAP, September 2002). Endorsed by scores of professionals and government agencies, such guidelines are a powerful tool for donor staff to work with government clients.

## Conclusion

Building financial services for the poor is essential and feasible. This can be done profitably. CGAP remains committed to using its resources in the most efficient manner to support this task. CGAP's operations constantly evolve to address the rapidly changing microfinance industry, but its core objective remains constant.

Everything CGAP undertakes is aimed to move microfinance industry in the direction that we believe will

help it reach the largest number of poor people with best products and services in the most efficient and rapid manner. The poor demand nothing less.

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# WORKERS' REMITTANCES AND MICROFINANCE: THE NEGLECTED NEXUS\*

## Introduction

**W**orkers' remittances may be simply defined as the portion of migrant workers' earnings sent back various ways to their family members or others in the home country or other countries than the country of employment. These remittances to

developing countries in Latin America, and Asia and the Pacific are increasing and playing a growing role in their economies. According to Ratha (2003, p.160)—who estimated the inflow of remittances based on the data in the International Monetary Fund's Balance of Payments Yearbooks—the inflows to the Asia and the Pacific amounted to \$27 billion in 2002, \$11 billion of which went to the East Asia and the Pacific countries while \$16 billion went to the South Asian countries. They were equivalent to 2.5% of the GDP in South Asia. In each region, one country accounts for over 50% of the total regional inflow: for example, India, the world's largest workers' remittance

recipient country, accounted for 62.5% of the inflows to the South Asian region, while the Philippines accounted for 58% of the total inflows to the East Asia and the Pacific region in 2001.

Bangladesh, Pakistan, Philippines, Sri Lanka, and Thailand were also among the top 20 developing country recipients of workers' remittances in 2001 (Ratha, 2003, p.159). However, the estimates based on IMF data are, admittedly, underestimates of the actual amounts received, for several reasons. These include accounting practices adopted by the central banks of respective countries, extensive use of informal mechanisms by workers to remit money to their countries and under-valuation or exclusion of in-kind remittances (see Puri and Ritzema, 1999). The purpose of this note, however, is not to discuss estimation issues but to highlight the nexus between workers' remittances and microfinance, and thereby encourage microfinance institutions (MFIs) and those who support microfinance development to explore business opportunities that would contribute to both social mission and sustainability of MFIs.

Top Six Asian Country Recipients of Workers' Remittances, 2001

Country	Remittances (\$ billion)	Remittances (as a percentage of) <sup>a</sup>		
		Exports	Imports	GDP <sup>b</sup>
India	10.0	23	20	2.1
Philippines	6.4	20	20	9.0
Bangladesh	2.1	42	25	4.6
Pakistan	1.5	16	15	2.9
Thailand	1.3	2	2	1.1
Sri Lanka	1.1	23	19	7.8
Total	22.4	14	13	2.9

<sup>a</sup> Author's computations.

<sup>b</sup> Gross domestic product (at market prices).

Source: Ratha (2003, p.159).

\* The author gratefully acknowledges the comments of Udara Fernando and Vicky Tan.

Workers' remittances have been widely discussed by development economists, policymakers, and others interested in economic and social development. But until recently, the focus of the discussions has been in general on such issues as their impact on balance of payments, exchange rates, and social development of the workers' families, among others. The significance of workers' remittances for microfinance development and poverty reduction has received only scant attention.

### Conventional Wisdom

The lack of emphasis on the nexus between workers' remittances and microfinance appears to have been a result of several, somewhat unrealistic, assumptions.

- Remittances finance largely daily consumption of the recipient families and their purchases of consumer durables—refrigerators, televisions, radios, and housing investments, not income-generating economic activities.
- Only a negligible proportion of remittances are saved in financial assets.
- Those who receive remittances do not belong to the target group of MFIs.

### New Perspectives

These assumptions, and the views based on the assumptions, appear to be changing. MFIs are increasingly interested on workers' remittances. This change appears to be a combined result of several developments.

- The massive increase in the flow of migration has substantially amplified the flow of remittances. For example, the inflow to Sri Lanka increased from \$442 million in 1991 to \$1.1 billion in 2001. The other reason is the increasing attempts by both developed and developing countries to curb money laundering. This has encouraged workers to use formal rather than informal channels (El-Qorchi, December 2002; Puri and Ritzema, 1999) when they remit money. For example, workers' remittance inflows to Pakistan

sharply increased from about \$1.1 billion in fiscal year 2001 to about \$2.4 billion in FY2002, largely because of the international crackdown on the Hundi network, especially in the United States and Britain after the 11 September 2001 terrorist attacks (Ratha, 2003, p.171).

- There seems to be an increasing recognition that a significant portion of the remittance flows goes to poor and low-income families, especially to women and children in those families. This has encouraged MFIs to take a fresh look at their own business approaches. Some researchers have concluded that it is the poor who migrate because they have the most to gain from migrating.
- The involvement of formal, regulated financial institutions in microfinance is increasing. Some of these institutions have a charter to engage themselves in remittance business. A number of MFIs have already entered into this business. This appears to be having an effect on other MFIs though still not substantial.
- Funding agencies supporting microfinance development have also begun to recognize the importance of remittances and their role in microfinance development. This has helped put the subject on the radar screen of many stakeholders. For some time, the Social Finance Unit of the International Labor Organization has been paying increasing attention to the subject. In November 2000, the Unit organized a workshop in Geneva to discuss it. In May 2001, the Inter-American Development Bank's Multilateral Investment Fund (MIF) conducted a regional conference on "Remittances as a Development Tool." MIF has already approved a few projects to finance remittance business in several Latin American countries, including Mexico and El Salvador. The World Bank's Global Development Finance Report 2003, issued in April 2003, devoted an entire chapter (Ratha, 2003, pp. 157-175) on workers' remittances with an excellent analysis of their trends and economic effects, among others.

- ADB's Private Sector Operations Department is preparing a study of the Filipino overseas workers' remittance to the Philippines to help identify measures needed to encourage competition in the remittance market and reduce transaction costs of remittances, and promote linkages with small and medium enterprises and microfinance development.
- The United Kingdom's Department for International Development and the World Bank will hold a joint international conference on "Development Impact and Future Prospects of Migrant Labor Remittances" during 9-10 October 2003 in London.
- The academics have begun to explore the issues surrounding the remittances-microfinance nexus, and the studies on the subject are increasing. A study on Mexico, for example, estimated that "remittances are responsible for almost 27% of the capital invested in microenterprises throughout urban Mexico" (Woodruff and Zenteno, 2001, p.1). The frontier of knowledge on the subject seems to be expanding, as a result of these.

### Establishing the Nexus

Some MFIs have already entered into the business of money transfers, mobilizing savings on the basis of remittances and providing microcredit based on remittances. A number of brand new microfinance banks established in recent years are among them. Procredit in Bulgaria, Microfinance Bank in Serbia, Microfinance Bank in Ukraine, Financiera Calpia in El Salvador, and Microenterprise Bank in Bosnia and Herzegovina are examples of such banks. Arguably, the latter has the heaviest involvement in this business.

The ACLEDA Bank in Cambodia, a leading microfinance bank, is involved in local money transfers. In 2001, this bank transferred \$7 million in remittances; this amount increased to \$28 million in 2002. ACLEDA has also established a business relationship with the Western Union in carrying out international money transfer business.

Bank Dagang Bali, a well-known private microfinance bank in Bali, has also been involved in money transfers for many years.

The World Council of Credit Unions (WOCCU) has also promoted remittance business within its affiliate credit unions. It has developed an International Remittance Network (IRNet), and through a partnership agreement with the Vigo Remittance Corporation, has become active in providing money transfer services to members of its affiliated credit unions (see Box).

Recently, recognizing the potential for strengthening the nexus between remittances and microfinance development, ACCION International

entered into a partnership with La Caixa, a leading European savings bank based in Spain, to develop a new remittance product for ACCION's partner microfinance programs in Latin America. According to ACCION, La Caixa currently serves a large population of Latin American immigrants in Spain, providing money transfer services for thousands of men and women. The new remittance plan will allow families receiving remittances through ACCION's microfinance partners to channel a portion of these funds toward future investments such as housing or education (<http://www.accion.org>). The Opportunity International is also examining the potential for assisting its

partner MFIs to provide remittance services.

## Conclusion

The remittance business can be an important source of income and funds for MFIs. Because most MFIs rely heavily on interest income, they are vulnerable to potential volatilities in the income from this source. Thus income from remittances-related business can help MFIs reduce this vulnerability. Also, this can be an important source of profits directly and indirectly. This is evidently true in the case of the Microenterprise Bank in Bosnia and Herzegovina. MFIs can cross-sell their

(continued on next page)

# The International Remittance Network — An Innovative Intervention

**T**he International Remittance Network—IRnet—is an electronic funds transfer service developed by the World Council of Credit Unions (WOCCU)<sup>1</sup> and the New York-based VIGO Remittance Corporation<sup>2</sup> to provide credit union members a safe, rapid, and relatively low-cost method of sending money overseas or domestically in the United States (US). The service started in July 2000. Currently, IRnet provides this service to over 40 countries in Latin America, Asia, Africa, and Europe; and people can receive money at over 3,200 locations in some 36 US states. The service has benefited a large number of Latin American migrants, particularly those from Mexico, El Salvador and Guatemala. The Asian countries covered by the service include Bangladesh, India, and Philippines. The service is open primarily to the members of the credit union. However, non-members can also send money provided that they have potential to become a member, based on the credit union's field of membership.

IRnet is a safe method of sending money for migrants when compared with services operated by convenience stores or check cashing outlets which most migrant workers relied on for sending money to their families back home.

IRnet is also efficient: its fees are relatively cheaper. Initially it charged a \$10 flat fee to send up to \$1,000. Currently for the same fee, a person can remit up to \$1,500. WOCCU claims that compared to Western Union or Money Gram, this service is between 33% and 50% less expensive for members. When IRnet entered this market first, most other service providers were charging a flat fee of \$30-45 regardless of the amount sent or destination. In addition, there were other costs such as exchange loss involved in dealing with other service providers. IRnet provides a guaranteed exchange rate at the point-of-sale and offers the best foreign exchange rates. The sender can also send a message to a recipient of up to 48 words free of charge. Those who send money to Mexico get a free 3-minute phone call to Mexico. IRnet does not charge foreign recipients a fee for accepting transfers. Nor do the recipients need to have an account to receive the funds.

IRnet service is fast. It takes only a few hours at the most for a recipient to get money from the time the remittance transaction is completed by the sender at the US end. And money is delivered to the recipients' residence in some countries, including the Philippines.

The service benefits not only members of the credit unions but also the credit unions themselves. With the addition of this service, credit unions have been able to differentiate themselves from other financial institutions and improve their competitiveness in the market. The unions have also found a new source of income. Evidently some credit unions have experienced that those who receive remittances through the unions open accounts for the first time with the credit unions.

Perhaps, the IRnet's biggest impact has been generated through the changes it triggered in the broader remittance market. Although it is not yet a major supplier of this service in the US market, IRnet has certainly added an element of competition to this otherwise highly segmented market. Its entry and subsequent expansion of its operations over time has compelled the other service providers to offer better prices than before. According to one estimate, prices have dropped approximately 37% for transfers to Mexico. While this drop cannot be solely attributed to the entry of IRnet, it has been an important factor. This drop in prices have benefited a far larger number of people than the number directly served by the IRnet.

<sup>1</sup> WOCCU is an international trade and development organization for credit unions operating in 92 countries around the world.

<sup>2</sup> VIGO Remittance Corporation (VRC) was formed in 1985 primarily to serve the money transfer needs of the Brazilian community. With increasing demand, its operations grew rapidly over time. VRC has been offering international money transfer services as a bonded, licensed, and regulated nonbank financial institution.

Sources: [http://www.woccu.org/prod\\_serv/irnet](http://www.woccu.org/prod_serv/irnet); <http://www.vigousa.com>;  
E-mail communications to David Grace of WOCCU.

products to clients involved in remittances. MFIs may offer special deposits, investment loans, and other type of loans to the families who receive remittances. The expansion of their business in this manner can also help MFIs realize the scope of economies and improve efficiency and sustainability. The efficiency gains can be shared, to some extent, with their clients through lower prices on microcredit. More importantly, they improve the value of the institutions to the poor and low-income people.

Most countries in the past have attempted to divert workers' remittances to new businesses through special business development programs. However, such efforts have had limited outreach and success for various reasons: first, when workers are still overseas, the programs have to focus on other adult family members who have access to the inflow; second, family members may not have the required business acumen or experience to productively use such programs.

The economic impact of remittances on low-income and poor households, however, can be improved more effectively by encouraging remittance recipients to invest a portion of the inflow in financial assets that provide them safety, reasonable returns, liquidity, and greater capacity to leverage funds. Pooling remittances in MFIs in terms of deposits enables MFIs to finance a wide range of activities, and generate a potentially greater economic and social impact than what may be feasible with special targeted business development programs. Also, MFIs themselves can use remittances to leverage more funds in the commercial markets to finance their growing lending operations. This will enable the MFIs to not only diversify their funding sources but also increase the breadth and depth of their outreach. Over time, with increasing experience, innovative

MFIs will find numerous ways of turning workers' remittances into a productive business that would contribute to their social mission and profitability. Those who receive remittances may also find that MFIs' involvement will provide better ways to manage their inflows. These improvements in both the supply and demand sides can make a significant contribution to increase the welfare of the poor and low-income households—the target group of MFIs. Thus remittance business appears to be a win-win proposition for MFIs and their clients.

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## BOOK REVIEW

BY XIANBIN YAO

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Manfred Zeller and Richard L. Meyer, eds. 2002. *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact*. Published for the International Food Policy Research Institute. The John Hopkins University Press, Baltimore. xxii + 424 pp.

This volume focuses on analytical approaches to assessing potential tradeoffs and synergies among the three policy objectives in the triangle of microfinance: financial sustainability, outreach, and impact. The demonstrated effort of clarifying conceptual linkages and establishing strong empirical basis for microfinance operations distinguishes this book from many other studies in the literature. As Jonathan

Morduch stated in his review of the book, "The studies [in this volume] replace advocacy with analysis and come together to form a clear agenda to push the field forward" (<http://www.press.jhu.edu/press/books/titles/f02/f02zetr.htm>).

The book contains 17 chapters. The first chapter introduces thematic topics and presents the framework of the discussion in the book. The last chapter summarizes the book's findings and highlights policy and research implications. The remaining 15 chapters are structured into four subject matters. While all deal with analytical approaches and methods of analysis, each chapter offers a distinct perspective or a method of analysis. Together the volume shows the character of diversity with unity. Many chapters of the book represent the outcomes of a multi-country research program on rural financial policies for food security of the poor, set up by the International Food Policy Research Institute. The research findings reported in several chapters had been published in the conference proceedings for the multi-country program.

In the introductory chapter, the editors draw immediate attention to the dearth of

sound empirical research on the demand side of microfinance. This has limited our understanding of the outreach, financial sustainability, and welfare impact of microfinance. "This book is designed as a contribution to empirical knowledge and research methods for measuring households' access to and demand for financial services." (p. 2) With this purpose, the book's editors then present the conceptual framework on the triangle of microfinance. They emphasize the need for better understanding of the potential tradeoffs and synergies among the three policy objectives, which provide sound empirical basis for innovations at the institutional level and changes to macroeconomic and sector policy framework and socioeconomic environment. Innovations and policy environment constitute internal and external enabling factors that contribute to improving the overall performance of financial institutions.

The five chapters in Part I present approaches to the demand analysis. In Chapter 2, Zeller and Sharma focus on the linkages between household food security



and access to formal credit, savings, and insurance services that draw on the empirical results of the multi-country research. They distinguish three pathways through which financial services affect households—income generation, asset/risk management, and consumption smoothening—and highlight the diversity of demand for financial services. In Chapter 3, Nguyen et al. shows that the nature of local environment affects household demand for and use of financial services. Due to seasonality of economic opportunities and also to the uncertainty about crop yields and market conditions, the poor in Burkina Faso demand not only credit but also savings and insurance services to smooth income and consumption. Chapter 4 highlights the importance of demand-side considerations from another perspective. Stanton examines the composition of borrowers in four distinct lender types in rural Mexico and observes that there appears to be considerable leakage of public program funds to non-targeted groups. A sign of the lender's mission drift? Not quite so. Demand-side factors may have something to do with the poor targeting. If the perceived costs of borrowing from a lender outweigh the benefits, a target client may choose not to borrow from the lender. This demand-side consideration underlines the importance of innovations in product design and services delivery that will enhance voluntary participation and self-targeting by clients.

In Chapter 5, Zeller and Sharma further advance the credit demand analysis by distinguishing between the access to credit and the demand for credit. This conceptualization and differentiation may sound simple, but its significance cannot and should not be discounted, at least, for two reasons. First, these two concepts—access to credit and the demand for credit—are used loosely by most analysts. Second, they have significant implications for design of policy and operations. Factors that affect the access to credit and actual borrowing may be different. For example, within a certain borrowing limit, the actual level of borrowing will depend on the availability of complementary inputs and the factors related to credit programs. Understanding the different determinants of access to credit and demand for credit will help design better microfinance programs and evaluate welfare impact. In Chapter 6, Lyne and Darroch present a case study on mortgage scheme for land purchase in South Africa and show how the poor's credit need for financing the long-term investment can be addressed by innovative design in financing instruments. Taken together, the five chapters in Part I

emphasize systematic and rigorous demand analysis and underscore a central message of the book that demand-driven innovations can bring out the synergies among the three policy objectives.

Part II is about assessing the outreach and financial sustainability. It presents alternative methods for measuring the depth of outreach and also discusses the importance of different types of lending technologies in meeting the three policy objectives. In Chapter 7, Paxton and Cuevas develop a simple depth of outreach index, using readily available data on microfinance institution (MFI) client profiles such as the average income, and the proportions of female, rural, or uneducated clients, and comparing them with the country averages. In Chapter 8, Navajas et al. construct an indicator of absolute poverty based on variables that are used for the national poverty assessments. Applying the poverty measure to five MFIs in Bolivia, Navajas et al. find that none of them reaches the poorest of the poor. In terms of the types of lending technologies, they find that richer clients, who are willing to offer collateral for loans, tend to be served by individual lenders, and that poorer clients without acceptable collateral are served by group lenders.

In Chapter 9, Zeller et al. present a method to measure the relative poverty of MFI clients in comparison with the general population living in the operational area of the MFI. The relative poverty measure is based on a range of indicators describing different dimensions of poverty and for which credible information can be quickly and inexpensively obtained. In Chapter 10, Heidhues et al. compare the transaction costs of three different lending programs in Cameroon. Two such programs use group-lending technology, and one lends directly to individuals. The study distinguishes pure transaction costs from the cost due to loan default. The results indicate that group lending may not always have lower transactions costs, either for the lender or for the borrower. The group lender had to bear the costs of forming and training groups. The borrowers had to bear high borrowing costs due to the costs of high loan default. However, other factors are at work, complicating the above results. For example, the individual-based lending program serves a wealthier clientele and predominantly serves clients in cities or rural towns. This study points out that outreach and financial sustainability need to be assessed together to highlight the potential tradeoffs. It underscores the importance of institutional and product innovations in helping reduce transaction costs and improve loan recovery.

The topic of measuring the impact of microfinance is covered in Part III. Chapter 11 by Sharma and Buchenrieder provide a comprehensive survey of impact studies. They group the studies into two categories — those

focusing on investment-led benefit impact studies and those on insurance-led benefit studies. The studies in the former category present mixed results on the impact of credit, while those of the latter category show better evidence of consistent positive impact. This is largely because profitability of investment depends on the availability of complementary production inputs. Sharma and Buchenrieder also highlight methodological issues on impact evaluation including, those relating to differentiating the impacts of financial and nonfinancial services provided jointly by microfinance institutions and to combining quantitative and qualitative methods in impact assessment. The authors also emphasize cost-saving innovations that can improve welfare impact as well as financial sustainability. In Chapter 12, Diagne analyzes the impact of access to credit on farm productivity in Malawi. The study distinguishes access to credit and participation in borrowing, and clarifies the channels of effect of access to credit on farm productivity. It highlights that credit access may not have a positive impact on farm productivity if complementary inputs are not available to farmers—a well-known finding of many previous studies on the subject. In Chapter 13, Kochar presents a different kind of impact analysis by examining the effect of adult illness on the savings decision of rural Pakistani households, especially the effect on the composition of asset portfolios. The analysis shows that the ill health of male members of the household affects the poverty of households through adverse portfolio shifts. The study points to the need for designing emergency loan products and developing insurances to meet the household demand for such services.

Part IV is about the role of public policies for microfinance. In Chapter 14, Lapenu adopts a financial system perspective and reviews different models of how the state, private sector, and nongovernment organizations have played their respective roles in rural finance. The consideration of market failures provides a strong case for the public sector to play a direct role in assisting the microfinance start-ups and in supporting the state-owned institutions that serve the poor. In Chapter 15, Yaron and Benjamin take a broad development perspective and highlight that a strategy for rural poverty reduction is to be based on a comprehensive assessment of the constraints, including that on the access to finance, and to determine public investment priorities. Both chapters emphasize that the state plays a significant

(continued on next page)

indirect role in improving policy environment and a sound legal and regulatory framework. In terms of the triangle of microfinance, an enabling policy and regulatory environment, in turn, facilitates institutional innovations by the microfinance industry to achieve the policy objectives of financial sustainability, outreach, and impact. Chapter 16 reviews the experience of the People's Republic of China as a transition economy in transforming the rural financial system.

Chapter 17 (or Part V) concludes the volume. In this chapter, the editors provide their substantive reflection on key findings and issues discussed in the preceding chapters, and also present their views of

how the microfinance policy and research agenda will evolve in future. They emphasize, "MFI field operations have far surpassed the research capacity to analyze them, so excitement about the use of microfinance for poverty alleviation is not backed up with sound facts derived from rigorous research... Given the current state of knowledge, it is difficult to allocate confidently public resources to microfinance development." They indicate that much more systematic comparative analysis of MFIs is needed to evaluate the alternatives of upgrading informal institutions, downscaling the outreach of formal institutions, and creating new institutions from scratch to serve the poor (p. 376). They suggest that the further research

needs to focus particularly on developing techniques to consistently assess depth of outreach and effectively measure welfare impacts. The editors conclude the chapter by pointing out that significant and unresolved challenges remain of agricultural finance. "A vast amount of work is required to understand the market for rural finance and create the innovations necessary for successful financial intermediation" (p. 377).

The book, on the whole, provides an in-depth analysis of the three corners of the microfinance triangle and also offers much needed guidance for future research. A must read for those who are genuinely interested in the subject of finance for poverty reduction.

## SELECTED READINGS ON MICROFINANCE

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**ADB Approves a Microfinance Technical Assistance for Azerbaijan**

The Asian Development Bank (ADB) approved in April 2003 a \$400,000 technical assistance (TA) grant for microfinance development in Azerbaijan. The TA will help formulate a microfinance development strategy to provide a sound policy, institutional, legal, and regulatory environment. The strategy will help microfinance and rural finance institutions expand and sustain their operations in offering a wide range of financial services.

Nearly half of Azerbaijan's total population of over 8.1 million is estimated to be in poverty although the country's gross national product per capita is about \$610 (as of 2000). A large demand for microfinance services exists but the outreach of microfinance and rural finance institutions is limited in scope, breadth, and depth. This limits their potential impact on poverty reduction. The microfinance industry, currently dominated by international nongovernment organizations, reaches only about 30,000 borrowers.

**Technical Assistance to Promote Business Development Services in Tonga**

ADB will help Tonga promote business development services (BDS) for micro and small enterprises through a technical assistance (TA) grant of \$250,000, approved in May 2003. The TA will facilitate market development for BDS and improve the performance of small and microenterprises through their utilization of BDS. The expected outputs of the TA includes a commercially operated web site on business information relevant and useful for small and microenterprises.

**Nimal Fernando Elected to Executive Committee of Consultative Group to Assist the Poor**

In a recently concluded election, Nimal Fernando, Lead Rural Finance Specialist of ADB's Regional and Sustainable Development Department, was elected to represent the America and Pacific constituency in the Executive Committee (EXCOM) of the Consultative Group to Assist the Poor (CGAP). The America and Pacific constituency consists of the ADB; the Inter-American Development Bank; and the development agencies of Australia, Canada, Japan, and the United States. The new EXCOM of CGAP consists of 9 members in addition to the ex-officio member who is the Director of CGAP.

CGAP was established in 1995 with the participation of 10 multilateral and bilateral funding agencies, including ADB. Currently, CGAP has 29 member organizations that support microfinance, and is dedicated to moving the industry toward the scale required to serve millions of poor people worldwide.

**The New Executive Committee of the Consultative Group to Assist the Poor**

EXCOM Representative	Consultative Group/Constituency or Industry
Hege Gulli, Norwegian Agency for International Cooperation	Europe 1 (Denmark, European Bank for Reconstruction and Development, Finland, Germany, Italy, Norway, Sweden, Switzerland)
David Stanton, (Elected Chair), Department for International Development, United Kingdom	Europe 2 (African Development Bank, Belgium, European Commission, France, Luxembourg, the Netherlands, United Kingdom)
Frank DeGiovanni, Ford Foundation	United Nations Agencies/Foundations (International Fund for Agricultural Development, International Labor Organization, United Nations Development Programme/United Nations Capital Development Fund, Argidius Foundation, Ford Foundation)
Nimal A. Fernando, Asian Development Bank	America and Pacific (Asian Development Bank, Australia, Canada, Inter-American Development Bank, Japan, United States)
Carlos Cuevas, The World Bank	The World Bank
Brian Branch, World Council of Credit Unions	Industry
Marilou van Golstein Brouwers, Triodos Bank	Industry
Fazle Abed, Bangladesh Rural Advancement Committee (Microfinance Institution in Bangladesh)	Industry
Carlos Labarthe, Financiera Compartamos (Microfinance Institution in Mexico)	Industry
Elizabeth Littlefield, Director and Chief Executive Officer, CGAP (Ex-Officio Member)	Consultative Group to Assist the Poor

## NEW ADB PUBLICATIONS ON MICROFINANCE

**Commercialization of Microfinance: Sri Lanka.** December 2002. Asian Development Bank: Manila. Hard copy price: \$10 (inclusive of shipping charges).

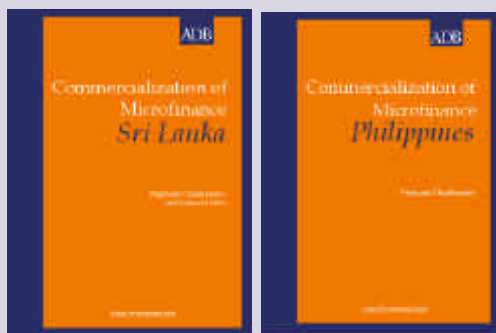
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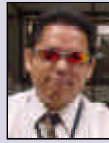
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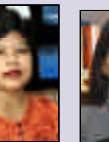
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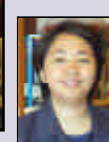
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