

The Haiti Reconstruction Effort
Promoting Small and Micro Enterprise in Haiti
Testimony before the House Subcommittee
On International Monetary Policy and Trade
By
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Mr. Chairman and Honorable Members of the House Subcommittee on International Monetary Policy and Trade,

Thank you for providing me the opportunity to talk to you about my views on the Haiti Reconstruction Effort and on the critical role that micro, small and medium enterprises (MSME)– and especially insurance – should play in this process.

Following the biggest catastrophe that Haiti and maybe our world has known in terms of casualties and deaths, I think we have several learning opportunities in front of us.

Given that Haiti cannot get back on its feet alone, I think the first place the International community could start addressing how to help build back a better Haiti is by asking a few fundamental questions:

What can we learn from this catastrophe?

What areas are of utmost importance in rebuilding this nation?

What ingredients were missing in the previous attempts to get Haiti on a sustainable path of social and economic development?

Is insurance indispensable in building a stronger MSME sector?

I would like to take this opportunity to stress the point that one of the important missing links in the Haitian prosperity chain is risk management. When we are thinking about important issues in the socio-economic development of Haiti such as education, health care, justice systems, energy, government capacity-building, the role of the private sector, and finance there is a tendency to forget about the importance of risk management, and more specifically insurance.

In his book "Against the Gods, a remarkable story of risk" Peter Bernstein, argues that the notion of bringing risks under control is one of the central ideas that distinguish modern times from the distant past. If we think about it, it is also one of many reasons behind the difference between developed countries and those considered underdeveloped.

There are two great citations that I believe illustrate very well the importance of insurance:

"New York was not created by men but rather by insurers...without insurance, there would not be any sky scrapers because no workers would accept to work at such heights risking a deadly fall and leaving behind their family in misery. Without insurance, capitalist would not invest millions of dollars to build such buildings that a simple cigarette bud would reduce to ashes..." Henry Ford

"If it was possible for me, I would write the word insurance in each home and on each man's forehead, since I am so convinced that insurance can, at a moderate price, liberate families of irreparable catastrophes" Sir Winston Churchill

Observers argue that there is a direct correlation between the number of deaths following a catastrophe and insurance penetration rate in a society. A vivid example can be seen this year: Haiti faced a 7.2 magnitude earthquake with over 250,000 deaths and Chile, a much more developed country, faced an 8.8 magnitude earthquake (which is 500 times stronger) with less than a 1,000 deaths though twice as many buildings were damaged¹.

By looking at the penetration rate of insurance, which is the premium volume generated by a market as a percentage of GDP, and the density, which is the premium volume per capita, it is quite clear that developed nations understood very quickly and very early in their nation-building that insurance should play a major role in their strategy and therefore did put in place the proper mechanisms to promote the industry.

In the US, the penetration rate is +/- 9% with a density of just over 4,000.00 USD². This can also be seen in countries that have left the category of underdeveloped nations and are considered today as "emerging economies". They have a penetration rate between 2 and 6%. Chile one of the richest nations in South America has a penetration rate of 4% with a density of 344.00 USD.

In Haiti, however, the insurance penetration rate is close to 0.30% with a density of 3.4 USD while our next door neighbor the Dominican Republic has reached a 1.5% rate with a

¹ <http://www.csmonitor.com/World/Global-News/2010/0302/Chile-earthquake-facts-Chile-vs.-Haiti-in-numbers>

² http://media.swissre.com/documents/sigma3_2009_en.pdf

density of 64.30 USD³, and this rate is growing steadily. Translated in dollar amounts, it represents approximately \$25 million and over \$300 million dollars of premiums respectively.

By answering how Haiti can increase its insurance penetration rate we will surely help answer some of the fundamental questions posed above, and reduce reliance on international aid in case of future catastrophes.

Before exploring the possibilities on how to increase the penetration rate, allow me to take a few minutes to talk about the context in Haiti:

Due to its geographic positioning, Haiti is constantly exposed to natural disasters. Over the years, the socio and economic impact of weather-related risks have constantly increased due to the degradation of the environment. Most recently, in 2007 Haiti was hit by tropical storm Jeanne, and in 2008 alone, was hit by four storms in a three week period causing damages estimated at 15% of GDP.

On the financial side, only 25% of the population uses the traditional banking system. Of this group, over 80% of the activities are located in the area of the capital, Port-Au-Prince, with only 20% usage in by populations in the provinces.

There are an estimated 63,000 borrowers and an estimated 2,000,000 depositors. Only 30% of deposits return to the economic system in the form of credit.

On the micro finance level, which is estimated to be a potential market of at least a million borrowing clients, this sector is estimated at only 245,000 borrowers and 700,000 depositors. 85% of loans contracted by micro and small entrepreneurs are used for commercial activities rather than production or manufacturing which is much more durable in terms of development. 80% of Haiti's active and productive economy lies within the informal economic sector, which is the population in the pyramid that is the most vulnerable to risks. Following the earthquake, USAID through the project WINNER⁴ conducted a survey on the financial impact of several sectors of the economy and the results confirmed that out of an estimated 383,367 companies, 383,134 are from the MSME sector and 65.11% of the losses were suffered by this same sector. They were not insured.

Political instability has also resulted numerous times in the past 25 years in "manmade disasters" such as in riots, strikes, and civil commotion which constantly weakens economic capacity of the actors and especially the MSME sector.

³ http://media.swissre.com/documents/sigma3_2009_en.pdf

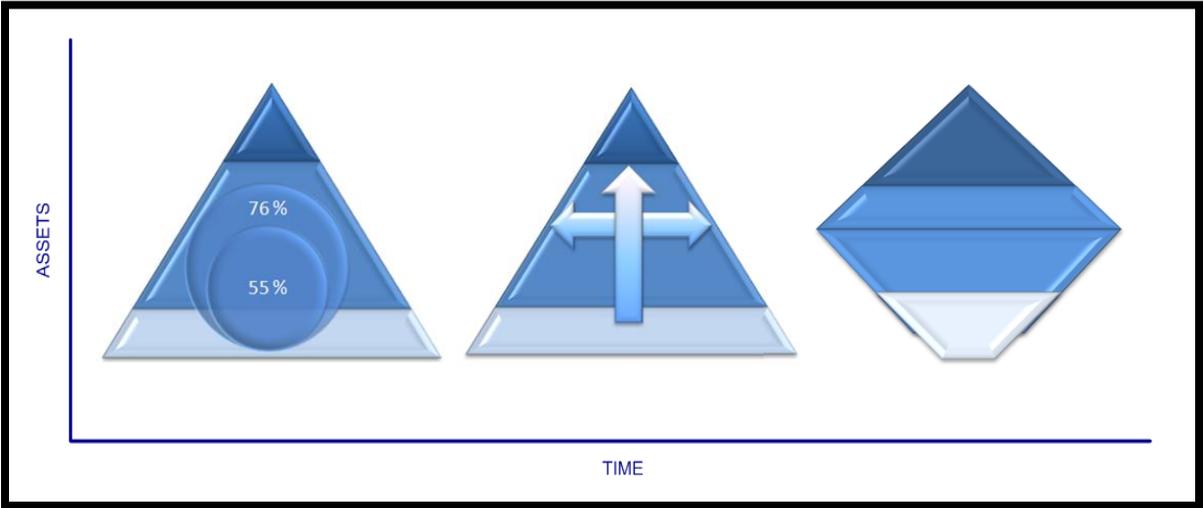
⁴ <http://winner.ht/>

Given this hostile environment to the investments required to rebuild Haiti, we need to strengthen, reinforce, support, supervise and facilitate the role insurance has to play in the economy. This would be a clear message that entrepreneurship and MSMEs are important in rebuilding Haiti, and risk transfer mechanisms are available to shore up investments. There are a great number of potential entrepreneurs that are above the micro finance level and bellow the traditional banking sector that needs to be supported with innovative financial products.

With the interest to facilitate and reduce the cost of money to young entrepreneurs and to give more businesses and Haitians access to insurance products, I would like to make two suggestions if I may:

- 1- On one side improve and increase access to financial products for the middle class and low income population to which are either attached or supported by insurance products.
- 2- On the other, build mechanisms of public-private-donor partnerships to give the majority access to social security and insurance products that can help them face the different shocks in their lives.

If those two suggestions are taken into consideration in the rebuilding effort of Haiti, the result will not be anything less than reshaping and strengthening our social pyramid (see diagram below) with a bigger and stronger middle class, more entrepreneurs and less people living close to or below the poverty line.



We also need to reinforce, formalize, accompany and regulate the MSME sector. By making this sector financially stronger, the social fabric of Haiti will be transformed, thus benefitting all involved:

- Government: a bigger fiscal base and a vibrant economy;
- Private sector: bigger buying power and better social services;
- Diaspora and respective countries: reducing remittances estimated to be at 1.6 Billion USD as per IDB 2006 survey⁵;
- International community: reducing dependency on foreign aid and a more stable Caribbean region.

With a mature MSME sector, we are pulling upward the bottom of the pyramid which will result in a diamond shape social structure with less people living below the poverty threshold.

1- Improving and increasing access to financial products to all Haitians:

Although it is necessary to support the traditional banking industry which is vital to the economy, in order to increase credit activities as a “jump start” to the economy, it is even more important to support other financial actors such as development banks and micro finance institutions. Traditional banking activities will not fulfill our hope that money will trickle down within the pyramid and the bottom will benefit.

We have seen and experienced the results of that approach before in other situations, not only in Haiti but also in other parts of the world. Today, traditional banking products are serving and are adapted to fit only the top of the pyramid’s needs. Entrepreneurs who do not qualify for traditional banking requirements will not be able to emerge. Meanwhile, if we take a bottoms-up approach, all layers of the pyramid will benefit, including the top which has products and services needed at the bottom.

While reinforcing the microfinance sector and giving the MSME sector access to financial products, we are creating more wealth, less social tension, and a new hope to this ever poorer Haitian population.

⁵ <http://www.iadb.org/news-releases/2007-03/english/remittances-to-haiti-topped-165-billion-in-2006-says-idb-fund-3637.html>

Besides the suffering and loss of dignity of the population, one of the major lessons learned following the earthquake of January, is that we need to do a better job at protecting the wealth that is being built in the MSME sector. Protecting that wealth means:

- 1) Access to insurance products and other social security mechanisms,
- 2) Capacity-building, regulation and supervision, education, for a strong insurance industry but most importantly,
- 3) A change in culture.

The challenge is to switch from a “God will prevail” culture that is prevailing in Haiti to a prevention culture. To be successful in that endeavor, we need to address two important aspects:

On one side, Communication and Education which is where the international community can play a major role by supporting, and investing more in USAID projects such as HIFIVE⁶ which has several success stories.

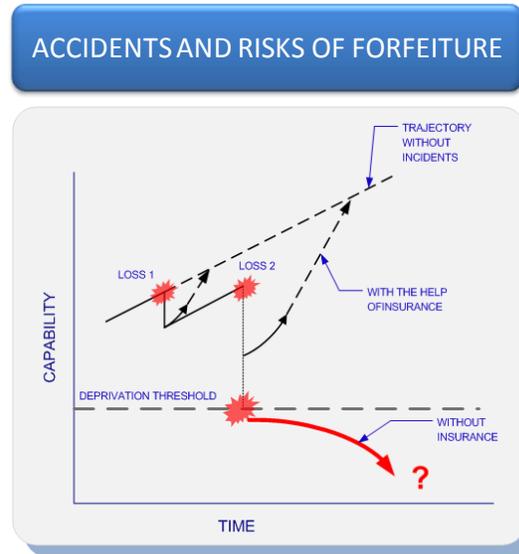
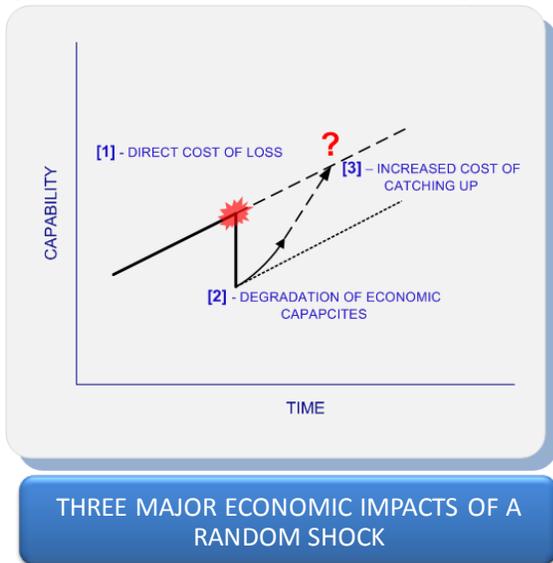
On the other, the international community needs to be firm in lobbying to the Haitian government that risk management is important. The Haitian Government needs to set the tone. The leadership of Haiti needs to lead the way.

Besides a couple of independent government-owned entities such as the Central Bank, and Banque Nationale de Credit, most if not all governments assets were not insured before the earthquake. The only insurance cover the Government will benefit from is the Caribbean Catastrophe Risk Insurance Facility (CCRIF)⁷. This facility was put together with the help of the World Bank to help the smaller nations of CARICOM with limited budget capacity and reserves face their immediate needs following a disaster. CCRIF, just as business interruption insurance does, covers governments for short term liquidity needs to start recovery efforts while maintaining government services. Haiti’s payout will be just under USD 8 million, which can be considered a drop in the bucket. The participation of Haiti to the CCRIF programs was supported by a grant from the World Bank to pay the premium for Haiti. The initiative was not taken by our government which is maybe the logical explanation why the payout is so low.

⁶ http://www.microlinks.org/ev_en.php?ID=42075_201&ID2=DO_TOPIC

⁷ <http://www.ccrif.org/main.php?main=14&id=45>

Besides the direct physical loss, we can take for granted that any and all person, business or government that does not have insurance protection is bound at some point or points throughout their life to face an economic capacity degradation following realization of one or more risks that they face. With the capacity to generate wealth weakened, future generations will also face hardship.



1 - Source: M. Vaté (Institut Thomas More)

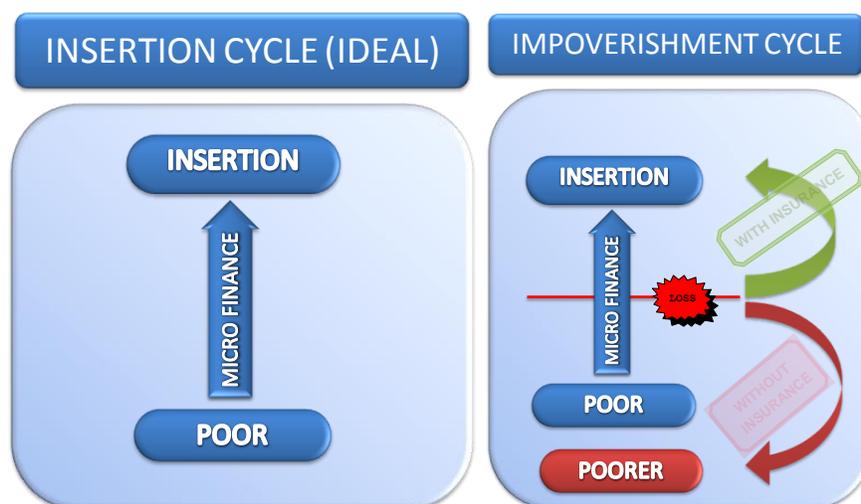
When thinking about how the International community can be more effective in helping third world countries lift themselves out of poverty, it is important to be thinking of poverty as a transitory state that is directly related to risk management.

Insurance is a powerful tool to help those it serves whether a business, person or government as a safety net so they can continue on their path to economic and social prosperity. Today, not only are most Haitians in the affected areas totally de-capitalized and becoming poorer, but worse, they lost the little that was left of their dignity and have no hope. Our government also was not spared.

“There are numerous studies that show when asked about financial products; low income populations prefer savings and insurance. For them it’s a vital stake: it’s about making up for an absent social system which is very frequent in a number of countries from the south.”

(I. Guérin et M. Roesch, Point de vue : Microcrédit, outil fragile, Le Monde du 29.11.05)

Protecting the wealth that can be created in the rebuilding effort of the MSME sector is not only a priority, it’s a must.



“Providing to the poor livelihoods without hedging against risks preventing their sustainability, could be counter-productive”

Sources : E.Gassana – « la pauvreté en Afrique et le Cadre Stratégique de Réduction de la Pauvreté, A.G FANAF, 13.02.2007

2- Build mechanisms of public-private-donor partnerships to give access to the majority to social security and insurance products:

A low Social security access level is the common denominator that is found in all underdeveloped countries. Haiti is no different. Less than 3% of the population has access to social security and less 200,000 people out of a population of 9.5 million have access to health insurance products. Faced with such a situation the population is forced to turn to unconventional risk management methods that are more costly such as loan sharks, taking their kids out of school, selling their assets, depleting the little savings they have. These methods always fall short of the expected results.

With innovative ideas and mechanisms, insurance and social security in underdeveloped countries can be complementary and not antagonists. For example, since crop insurance is very risky for traditional insurers and reinsurers, donor funds could be used to help insure this sector while at the same time, identifying and including small farmers that were totally absent from social security systems.

In this sense, it is crucial that the International community, in its strategy to help Haiti, support with both technical assistance and funds that can develop such initiatives: It is crucial to help Haiti establish the building blocks of a strong insurance industry that can really play both its social and financial role in the economy.

Moving forward, if we agree that insurance should be a pillar in the Haitian socio-economic life, the next question is what is the state of the Haitian insurance industry following the earthquake and how can we strengthen it so it can play its role in the rebuilding effort by continuing to assume risks?

Prior to the earthquake, although the industry had to face several challenges since the late 80's, including from riots on average every four years to natural disasters on average every two years, the industry could have been considered as stable and profitable. We can also consider that the industry, although not properly regulated, is being managed by trained and responsible professionals. The sector has practiced self-regulation to keep up with reinsurance requirements and international prudential norms.

Since the early nineties when all foreign companies pulled out of the market and the emergence of local companies came about, and up until the earthquake, not one company failed or went into bankruptcy. In the banking industry during that same period, the Central Bank had to intervene in at least five cases of failed banks in order to prevent systemic risks to the financial system.

Today, although the reinsurance world has been very proactive and respected its engagement, the insurance industry is in financial difficulty as the reinsurance cover bought by the local companies was not sufficient to cover the magnitude of the losses. When it came to reinsurance needs, insurers had placed more focus on hurricanes and riots and not enough on earthquakes.

According to the same WINNER⁸ survey done with the support of USAID, there is a gap in the system of approximately USD 40 to 60 million, and total assets in the system are very limited as insurers, due to limited capital, have transferred most of the risks and premium to reinsurers.

It is crucial and very much time-sensitive that the International Community assists local insurers in putting together mechanisms that can help them face their immediate obligations and cash liquidity crunch in the interest of preventing their failure and a systemic risk of the financial sector, while at the same time, allowing them to continue to assume risks. Unless insurers can continue to have the capacity to assume risks, credit will not be supported by adequate risk transfer mechanisms and therefore the cost of money to the MSME sector and entrepreneurs will continue to be prohibitive.

⁸ <http://winner.ht/>

The positive results we are hoping for from the financial sector as part of the rebuilding efforts of Haiti can be counterproductive if they are not managed properly from the beginning.

As of today, the insurance industry is poorly regulated, opaque and only has to satisfy some fiscal aspects which are blocking its development.

There is an opportunity today to not only save the insurance industry, which is vital, but also to properly regulate and supervise it so it can be up to par with the region in terms of prudential norms and transparency, while setting the foundations that will promote its growth.

The support of the International community to the insurance industry will result in a win-win-win scenario where the Haitian government wins, civil society and private sector as a whole wins, and the International community wins.

Mister Chairman, Honorable Congressman,

In closing, I would like to once again thank you for giving me the opportunity to express my views on the role of the MSME sector and especially the insurance industry in the rebuilding effort for a more prosperous and wealthy nation. It would be a pleasure to answer any questions you may have.

Thank you