Investing in Character: The social and economic returns to the IAF Microloan Program

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Skilled immigrants

- Key source of labour supply for addressing the expected labour market shortages in Canada
  - aging population and strong economic growth (Emery 2006; IAF March 31, 2009).

Credential recognition necessary for labour market integration

- skilled immigrants need access to finance to acquire Canadian credential
  - Need to take courses, sit exams, travel to sit exams, etc…
- Immigrants have difficulty getting this access
  - often lacking collateral and/or financial history necessary for access to credit in Canada

The Result? Underemployment for the immigrant and wasted human resources for society

- Alberta ministry of Employment, Immigration and Industry (2007)
  - 49 % of skilled immigrants in Alberta reported that they were overqualified,
  - 45 % were working in the fields which are not related to what they studied,
  - 64% found there was no consideration for their foreign education and/ or for work experience.
- Employers in 2007 were complaining of the difficulty hiring

The Immigrant Access Fund (IAF)

- on a not for profit basis to assist immigrants in acquiring the Canadian accreditation and training they need to work their field of expertise…
- Since 2005, has provided over 425 loans of $5,000
  - Since 2007 $1.6 million in loans disbursed
  - IAF is a “lender of last resort”
    - Have to show no other source of credit available
  - Loans on made on “character” rather than collateral

The IAF has had a 98% repayment rate

- The high repayment rate is more remarkable:
  - 65% of IAF borrowers were unemployed when they applied to the IAF.
    - Of the 35% that were employed,
    - 50% were working in ‘survival’ jobs and
    - 50% were working in their field, but not in positions commensurate with their skills and experience.
    - 20% of applicants had monthly expenses that exceeded their income.

IAF Model is Unique: Largest and most successful program of its kind in Canada

- other micro loan programs have bank partners to fund and approved loans
  - IAF delivers its loans through community agencies
  - IAF's loan capital comes from donations or from a bank line of credit
    - While more than $600,000 has been donated for loan capital, loans are presently being funded by a $1 million line of credit which has been secured by personal guarantees of Alberta business and community leaders.
- applicant eligibility
  - Unlike other programs, immigrants from all occupations are welcome to apply
    - IAF borrowers represent 63 different occupations
    - engineers, accountants, physicians and nurses account for 50% of loan recipients.
- use of funds
  - IAF loan funds may be used broadly;
  - other programs have restrictions (tuition only, for example) and often do not allow funds be used for living expenses.

The Contract

- Interest is paid at 1.5% above the Bank of Canada prime rate for business
  - borrowers pay interest only while completing their accreditation/training (maximum two years)
    - Have another two years to pay back the principal.
- Loan delivery costs are substantial for the IAF.
  - These costs likely lie between 50% and 100% of the loan principal.
- Private lenders are unlikely to be enthusiastic about making small loans like these without charging substantial interest costs to cover these high overhead costs.
  - 22% annual interest or higher!

The IAF is a social program

- Loan costs are subsidized
- borrowers are only expected to repay the loan principal and prime plus 1.5 for interest,
  - the IAF is not recouping loan delivery costs through the loan contract
- To date, almost all of the costs to deliver the program have been provided by the provincial and federal governments
  - (funding options were limited prior to IAF receiving charitable status).
  - Being so heavily dependent on government for operating funds leaves the IAF vulnerable to funding cutbacks and shifts in government priorities.

An evaluation of the IAF program amounts to assessing whether this use of resources provides “good value for money” for Alberta.

- The loan delivery costs are not paid for by the borrower and are a subsidy.
  - Loan principal is repaid to meet its opportunity cost
- The use of public funds and donated private funds for this kind of purpose is economically justified if the social return to that expenditure exceeds the opportunity cost of those funds.
  - In other words, would society be better off investing the funds in risk free bonds or expending them on a loan program that increases the earnings and employment outcomes of skilled immigrants?

If skilled workers are in demand

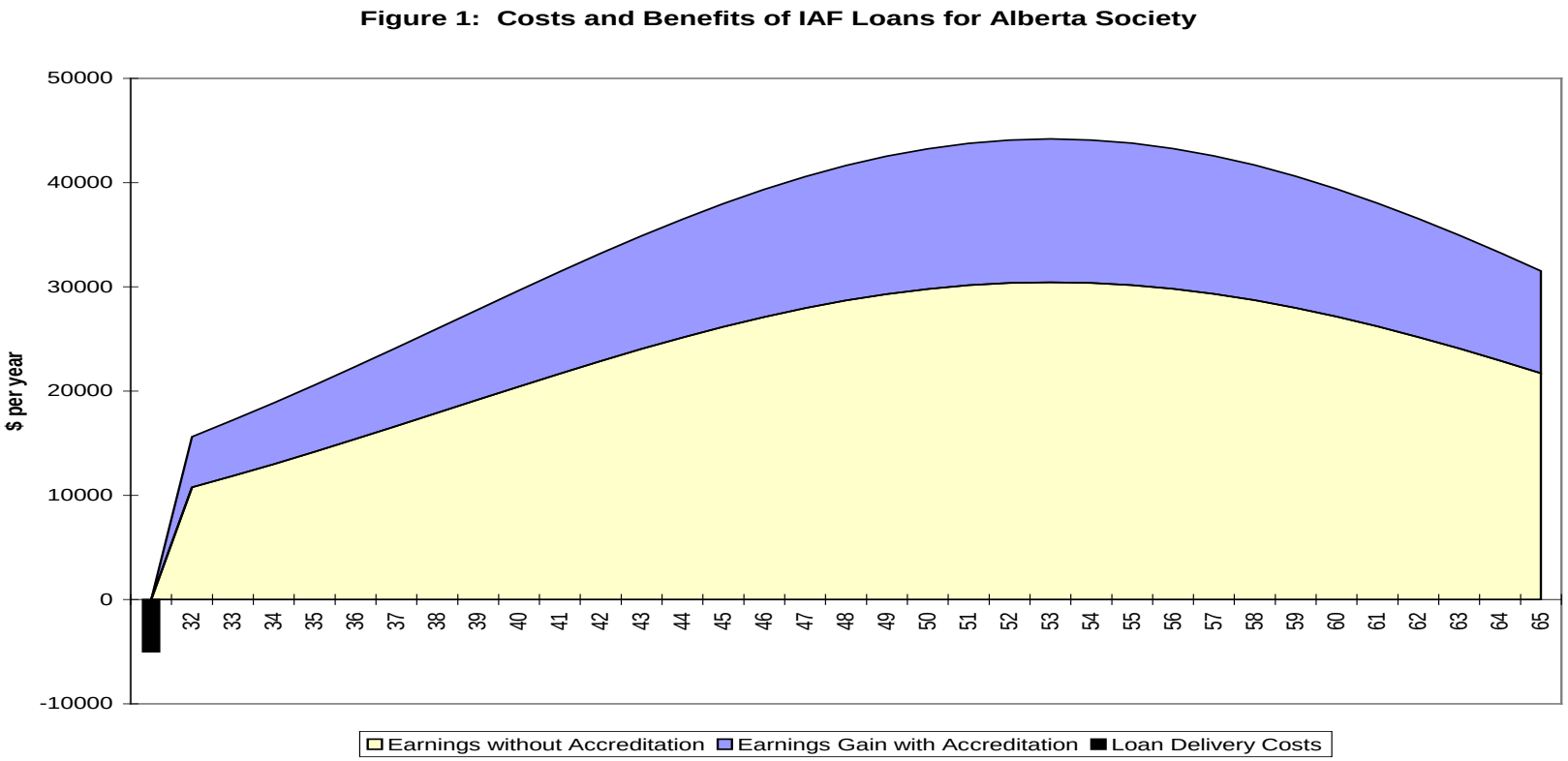
(no surplus)

- wages/earnings reflect a person's productivity (value of what they produce for society),
  - Earnings = value of their labour services to society
- The lack of recognition of credentials, and/or doubts about skills precludes many skilled immigrants from obtaining employment in their pre-immigration fields.
    - These immigrants typically work in occupations that generate lower incomes than those that value their education, training and credentials.
- The gain to society from recognizing an immigrant's credentials would be represented by the gain in income that immigrant earns in his/her chosen profession over that which they would have earned in their next best alternative occupation.

The subsidy to the IAF borrower to aid in the acquisition of Canadian credentials represents a social investment.

- Costs are incurred today in expectation of a stream of benefits into the future.
- Compares
  - costs of making loan to immigrant professional to acquire Canadian credential
  - Earnings gain of immigrant with Canadian credential over the remainder of their working life
    - Earnings measure a person's contribution to GDP

Social costs and benefits of an IAF loan



The Internal Rate of Return (IRR) to an investment

- the interest rate that would be required to equate the present value of the incremental increases in earnings associated with the education level and/or credential expected over the remainder of the working life with the present value of the costs incurred in acquiring the education and/or credential.

- The IRR is interpreted as the real annual rate of return to the investment
  - directly comparable to annualized rates of return to other investments like stocks, bonds or real estate.

A conservative scenario to estimate IRR

- The time horizon is 33 years (from age 32 to 65).
- Two types of uncertainty:
  - a) the immigrant may be unable to obtain Canadian credential
  - and b) the immigrant may be unable to find work in his/her area of expertise once accreditation is completed. In either case, the potential benefit of accreditation is reduced in proportion to the probability of successfully completing the program and finding work in the chosen area of expertise.
- Without a recognized Canadian credential, IAF borrowers would have earnings equivalent to those of a Canadian born worker with a high school education.
- With recognized credentials they would have earnings equivalent to those of Canadian born workers with a Bachelor's degree.
- Administrative costs are 100%

to Albertans is at least 33% per year!

Table 1. Real Annual Rates of Return from $5000 IAF Loan to a 32 Year Old Immigrant Borrower

Probability of Employment in Job Requiring Credential	*Average of all Occupations of IAF Borrowers*	*Nurses*	*Physicians*	*Engineering*
1.00	100% or more	100% or more	100% or more	100% or more
0.75	33%	100% or more	100% or more	100% or more
0.65	0%	58%	100% or more	32%

Cash : 0% annual rate of return

Your house is a “hedge against inflation” : close to 0% real return

Investing in stocks last 150 years: 9% per annum

IRR to a Cdn Medical Student: 2% to 3% per annum

Rate of return to risk free bonds: 4% to 5% per annum

Conclusions

- Albertans are receiving high returns from resources allocated to the IAF program
- ECONOMICS ADVICE:
  - this gets complicated
    - If it has a high return then do more of it
    - If it has a low return then do less of it