



AUSTRALIAN
COUNCIL
FOR
INTERNATIONAL
DEVELOPMENT

***Role of the private sector in promoting economic growth and
reducing poverty in the Indo-Pacific region***

**ACFID Response to Questions on Notice provided by the Joint
Standing Committee on Foreign Affairs, Defence and Trade**

August 2014

Question 1:

Could ACFID provide comment on the Government's newly announced 'Development policy and performance framework'.

ACFID has publicly and privately welcomed the Australian Government's new aid framework, *Australian aid: promoting prosperity, reducing poverty, enhancing stability* and the related performance benchmarks for the aid program outlined in *Making Performance Count: enhancing the accountability and effectiveness of Australian aid*.

ACFID has long advocated for the development of a clear and comprehensive policy statement on the purpose and objectives of the Australian aid program.¹ The new aid framework provides guidance and clarity for DFAT and other government departments involved in the provision of Overseas Development Assistance (ODA), for NGOs and other development partners, recipient countries and communities and for the Australian public.

ACFID welcomes the new aid framework's continued focus on promoting poverty reduction and inclusive and sustainable economic growth. Ultimately, the test of the new aid framework will be how well it assists the poorest people in developing countries.

ACFID has particularly welcomed the new aid framework's focus on the areas of health and education and on the empowerment of women and girls. Access to adequate healthcare, education and empowering women and girls are critical drivers of poverty reduction in developing countries. ACFID welcomes the prominence given to these issues across the new aid framework and the performance benchmark on empowering women and girls.

The new framework places particular emphasis on the importance of economic growth as a driver of poverty reduction and the role of the private sector as the 'engine of growth' in developing countries. ACFID agrees that promoting the development of the private sector in developing countries is critical to poverty reduction, and should be the driving focus of the Government's private sector development agenda. In low and middle-income countries, the private sector generates the vast majority of jobs and is by far the largest contributor to government revenues.

The private sector in developing countries is dominated by micro, small and medium enterprises (MSMEs), such as subsistence and small-hold farmers, fishermen, small manufacturers and small shop-owners. In low-income countries these enterprises account for approximately 70% of employment and 60% of Gross Domestic Product (GDP).² This rises to 95% of the employment and 70% of the GDP in middle-income countries.³

¹ See ACFID Publication, *Benchmarks for an Effective and Accountable Australian Aid Program*, January 2014

² European Parliament Report, 2014, *Financing for Development Pst-2015: Improving the Contribution of Private Finance* (Tabled with JSCFADT)

³ European Parliament Report, 2014, *Financing for Development Pst-2015: Improving the Contribution of Private Finance* (Tabled with JSCFADT)

Supporting the growth and development of MSMEs is therefore a powerful catalyst of inclusive economic growth in developing countries. ACFID believes the core focus of the Australian aid program's private sector engagement agenda should be addressing the key constraints to growth faced by MSMEs, such as access to financial services, education and training, and adequate healthcare.

The new aid framework also calls for greater involvement by Australia's private sector in the aid program. ACFID believes the private sector in Australia can make important contributions to promoting sustainable and inclusive economic growth and poverty reduction. In particular, there is scope to harness private sector financing and expertise for development objectives.

International and Australian experience strongly indicates that private sector participation in development works best where private sector interests are effectively and appropriately aligned with development outcomes. Typically, this is where outcomes can be clearly measured, where risk can be allocated to the appropriate party and where there is transparency and clear lines of accountability.

In their respective submissions to this Committee, ACFID and a number of its members have recommended mechanisms that can harness the expertise, financing and innovation of the private sector, and generate private profits while safeguarding the interests of those most in need. We stand ready to assist the Australian Government to ensure that private sector involvement in development achieves core development outcomes.

Finally, while the aid framework provides overarching objectives for the aid program, ACFID understands that the details on specific aid programs will be provided through the Aid Investment Plans (AIPs) for individual countries and regions. The AIPs will further define the scope of the Australian aid program and will ultimately govern its effectiveness on the ground in developing countries.

The AIPs are being developed by DFAT, with the Vanuatu and Timor-Leste Aid Investment Plans currently under review. ACFID believes the AIPs will be a critical test of the new aid framework and stands ready, with its members, to assist DFAT in their development.

Question 2:

The ACFID submission highlighted a substantial disparity between developing countries inflows and outflows of money, due to illicit outflows, including corruption. Could ACFID comment on possible options to capture more of those funds at the location where value is created, in order to re-invest them in the developmental priorities of other countries in need. (See 4.7)

Illicit financial flows have a devastating impact on developing countries. In 2011, illicit outflows from developing countries were estimated at around US\$950bn.⁴ Over the last decade, developing countries are estimated to have lost around US\$5.9tn in illicit outflows.⁵ Capturing these funds within developing countries could substantially increase the capacity of developing country governments to provide access to essential services for its citizens, stimulate economic growth and reduce dependency on foreign aid.

Illicit financial flows are a result of poor governance and regulatory regimes within a country. Strengthening the capacity and oversight capability of developing country governments is critical to tackling illicit financial flows and tax evasion.

The G8 and G20 are urging the international community to take action on several fronts to address money laundering, tax evasion, bribery and base erosion. Australia, as a member of the G20 and a technically sophisticated country, can assist developing countries to mobilise their domestic resources in a number of ways.

First, Australia should assist developing countries to combat illicit financial flows. The Australian Government can provide development assistance that builds technical capacity and capabilities within developing country governments and their tax authorities. This may include helping countries adopt efficient legal frameworks, providing training and capacity building workshops for officials or strengthening oversight procedures or institutions.⁶

Corruption acts as a catalyst for illicit outflows through money laundering, tax evasion and avoidance. As such, Australia should combine any technical assistance it provides with broader anti-corruption reforms and support for key institutions such as the judiciary and parliament.

Strengthening civil society and the media in developing countries is also critical to addressing illicit financial flows and corruption. Civil society organisations and the media play an important role in advocating against, investigating and publicising illicit financial flows. Australian aid should support civil society in developing countries to hold governments to account.

⁴ Transparency International Report, 2014, *Combating illicit financial flows: The role of the International Community*: http://www.transparency.org/files/content/corruptionqas/Combating_illicit_financial_flows_the_role_of_the_international_community_2014.pdf

⁵ Ibid

⁶ Ibid

Second, the Australian Government should be part of global solutions that will help stem illicit financial flows from developing countries. For example, the automatic exchange of information between national tax authorities will enable the detection of tax evasion and fraud, particularly when proceeds are transferred to another country.

In February 2014, G20 countries including Australia, endorsed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and the global standard on Automatic Exchange of Information (AEOI). ACFID urges the Australian Government to push for global implementation of these standards and ensure that developing countries are supported to participate and be included in the process.

Australia could push for greater transparency in international financial flows. G20 and OECD countries, through their banks and non-financial institutions, are the predominant recipients of illicit financial flows from developing countries. Financial institutions should scrutinise their customers, their source of wealth and monitor their transactions. Similarly, these institutions should identify the beneficial ownership of companies where a client is a corporation or trust. Research shows that corrupt individuals often use corporate vehicles to hide illicit funds.⁷

As the host of the G20 this year, the Australian Government should advocate for measures that strengthen the supervision of financial institutions in G20 countries and sanction institutions that fail to comply. Similarly, the Australian Government should push for G20 countries to publicly commit to establishing public registers of beneficial ownership information for companies and trusts. Increased due diligence requirements for Western financial institutions are crucial to address money laundering, corruption and illicit flows from developing countries

Finally, the Australian Government should establish a mechanism to repatriate illicit funds back to developing countries. Australia could follow the approach taken by the US and UK governments and establish a dedicated police unit that traces illicit funds into Australia and returns them to the locations where value was created. This would go some way to mitigate the effects of illicit outflows on developing countries.

⁷ Transparency International Report, 2014, *Combating illicit financial flows: The role of the International Community*: http://www.transparency.org/files/content/corruptionqas/Combating_illicit_financial_flows_the_role_of_the_international_community_2014.pdf

Question 3:

ACFID notes its support of “the initiation of a ‘grand challenges fund’ within the Australian aid program to support innovative business models or projects with a potentially high pro-poor impact.” (See 4.6) Further to the announcement of the Government’s new Innovation Hub, could ACFID comment on:

- **ACFID’s potential involvement and role in shaping the Hub**

ACFID welcomes the creation of the Development Innovation Hub. Innovation has a critical role to play in addressing the intractable development challenges faced in our region. A dedicated Innovation Hub within DFAT could make a considerable contribution to the design and implementation of innovative solutions to poverty. Moreover, its creation signifies the Government’s new attitude towards innovation and risk across all its aid investments.

ACFID stands ready to assist the Government to shape and establish the Innovation Hub in a number of ways.

As the peak body representing over 130 Australian development and humanitarian organisations, ACFID is particularly well placed to identify and bring together leading development innovators from across Australian and international civil society, academia and the private sector. ACFID and its members have worked collaboratively with prominent development economists, entrepreneurs, business people and researchers who have vast practical experience innovating for development. ACFID would be keen to use its networks and experience to assist DFAT to link in , and create lasting partnerships, with leading innovators from around the world and to suggest focus areas for the Innovation Hub’s work agenda.

While ACFID sees the value of situating the Innovation Hub within DFAT in Canberra, we believe it is vital that these innovation networks are also extended into developing countries, themselves.

In our experience, local innovators have important insight into local needs, constraints and opportunities, and understand how effective innovation can be scaled up. Effective and cost efficient innovation for development is often created when local markets are allowed to respond with their own solutions. Understanding the local context is crucial for ensuring innovation is end-user focused. For this reason, the most successful development innovations will be created by, or in collaboration with, development entrepreneurs on the ground in developing countries.

ACFID believes that the perspectives and expertise of leading local innovators, working on the ground in developing countries, are an invaluable resource for the Innovation Hub. ACFID and its members have strong partnerships with those already innovating in communities, research institutes and the private sector in developing countries. We are

keen to work with the Government to create networks of top innovators and creative thinkers not only from Australia and other developed nations but from across the developing world.

It is worth pointing out that the Innovation Hub announced by the Government does differ in an important way from ACFID's suggested grand challenges fund in that it is situated within a government department rather than a university. There are strong synergies between innovation and research, particularly in the monitoring and evaluation of potential innovations, and in the generation of new ideas. ACFID could assist the Government build ties between the Innovation Hub and Australian universities and researchers by leveraging ACFID's extensive University Network.

The ACFID University Network is a partnership between leading Australian Universities, ACFID members, and individuals working in the international development sector.⁸ Members of the University Network include development practitioners and academics from a range of disciplines including economics, environmental science, public health, anthropology. The Network is a unique interface between development research and the implementation of development projects on the ground – and provides a platform for development practitioners and researchers to collaborate on development projects, share learning and insights, and develop new ideas.

As such, ACFID believes its University Network would be a valuable resource for the Development Innovation Hub.

▪ **Suggested outputs and outcomes from the Hub, and options for monitoring and evaluation of projects?**

The Government should ensure that the Development Innovation Hub is mandated with a clear purpose or objective. The objectives of the Innovation Hub will necessarily inform its intended outputs and outcomes. Though the outputs from the Innovation Hub may be many and varied, they can be broadly characterised as: innovative new ways to tackle development challenges faced by poor people in developing countries. Some examples may include new technologies, new processes and techniques, pilot projects, ways to improve existing systems or procurement in the development context.

Ultimately, the outcomes from the Innovation Hub, in line with its core objectives, should be improvements to livelihoods and a reduction in the number of people living in absolute poverty. Innovations should target the poorest people in developing countries enabling

⁸ Including the Australian National University, Deakin University, La Trobe University, University of Queensland, University of New South Wales, University of Technology Sydney, Monash University, University of Melbourne and Murdoch University

them to realise their human rights and human potential, thereby contributing to and benefitting from sustainable and inclusive economic growth.

Monitoring and evaluation is at the heart of stimulating innovation. New innovations must be trialled and their progress monitored closely. How progress is monitored, however, is contingent on the specific nature of the innovation itself. Similarly, the evaluation of an innovation as a success or failure must be according to the specific objectives of the project.

Monitoring and evaluation is most effective where it is built into the actual design of a project, thereby ensuring that monitoring and evaluation processes are tailored to the precise characteristics and objectives of individual innovations. Monitoring and evaluation processes within the Innovation Hub will therefore likely vary by type of innovation.

A critical component of the monitoring and evaluation process is ensuring that key lessons are learned from both successes and failures. Learning constructively from past experience allows innovations to be iteratively adapted and improved, and optimises future decision making. ACFID recommends the Innovation Hub utilise a monitoring, evaluation and learning framework to ensure learning is a key element of its monitoring and evaluation processes, and builds a culture that supports creativity and an appropriate level of risk-taking.

Question 4:

In the submission, ACFID states that the new DFAT aid policy should have a strong focus, not only on these new ideas that are expected to come from the 'Innovation Hub,' but also on old methods that are tried-and-true (See 5.1). Could ACFID:

- **Provide examples of previous methods that have been successful, and that it considers should still be maintained with this balance of aid methods?**

The field of international development is characterised by its strong linkages between practitioners, policy-makers and academics. Development practitioners routinely work collaboratively with researchers and academics to pilot programs and techniques before implementing on a larger scale. Policy-makers draw from academic research and practical results to design effective development policy. These ties have become increasingly important amidst the growing trend towards evidence-based policy-making and program design.

As a result, there is a wealth of international and national evidence that demonstrates which development methods and initiatives have been effective at reducing poverty, and those that have not. ACFID recommends the Australian Government draw heavily from existing evidence on aid effectiveness to determine which previous methods should be retained in the Australian aid program.

A useful example of such evidence is the 2013 review of the Australian aid program by the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD).⁹ The OECD found that the Australian aid program had been particularly effective at targeting poverty reduction in least developed countries and fragile states. Australia performed well in comparison to other donors focusing on fragile states, ranking second only to the United Kingdom on the Quality of ODA index – an index which measures transparency, efficiency, fostering institutions and reducing the burden on partners.

The OECD review also commended Australia on its holistic approach to development which integrates gender equality, capacity development and disability inclusion across its suite of projects and programmes. Australia is a global leader on disability inclusion.

Australia was also found to be leading the world in the development of methods and strategies in the area of disaster risk reduction. Australia has developed tools and strategies that will allow for a successful expansion of risk reduction programming which protects hard-won development investments and at-risk communities.

⁹ OECD, 2013, *OECD Development Co-operation Peer Review: Australia 2013*, <http://www.oecd.org/dac/peer-reviews/OECD%20Australia%20FinalONLINE.pdf>

Similarly, the Australian Government's *2011 Independent Review of Aid Effectiveness*¹⁰ provides an in-depth assessment of the Australian aid program. One area of success identified by the Review was the increasing adoption of a partnership approach within the aid program including with civil society, multilateral institutions, private sector and Australian and international research organisations. The Australian aid program has been particularly effective at leveraging the expertise and networks of Australian NGOs working in international development.

An example of this is the Australian NGO Cooperation Program (ANCP), which provides funding and support to Australian NGOs that have successfully passed a rigorous accreditation process and whose development activities complement the objectives of the Australian aid program. The ANCP accreditation process was recognised by the 2011 Review as a sound mechanism for ensuring government aid funds are only channelled through effective Australian NGOs.

At the program level, the Office of Development Effectiveness (ODE) within DFAT undertakes extensive annual reviews of the effectiveness of the Australian aid program. Using data collected from a number of sources, the ODE evaluates projects and programs at the country and regional level, focusing on initiatives worth over \$3m. By way of example, the ODE has recently produced a detailed assessment of Australian aid programs in Timor-Leste.¹¹

In addition to evaluating country and regional programs, the ODE produces an annual report detailing the lessons learned from the Australian aid program. In *Lessons from Australian Aid 2013*, the ODE concludes that nearly 85 per cent of Australian aid initiatives were effective with 80 per cent found to be efficient.¹² The ODE reports are a useful guide to the development methods and techniques which have been proved successful within the aid program.

The Australian Government should also look to international experience and best practice to determine which development practices are effective at reducing poverty. Multilateral development banks (e.g. The World Bank), large bilateral donors (e.g. DFID, USAID), research institutes, universities and think tanks (e.g. Center for Global Development, Innovations for Poverty Action and the Brookings Institution) all publish extensive research on development methods that have been shown to reduce poverty, increase growth and improve standards of living.

¹⁰ Australian Government, 2011, *Independent Review of Aid Effectiveness*, <http://www.aidreview.gov.au/publications/aidreview.pdf>

¹¹ Australian Government, Office of Development Effectiveness, *Evaluation of Australian aid to Timor-Leste*, <http://www.ode.dfat.gov.au/publications/documents/timor-leste-eval-report-2014.pdf>

¹² Australian Government, Office of Development Effectiveness, 2014, *Lessons from Australian Aid: 2013 Report on independent evaluation and quality assurance*, <http://www.ode.dfat.gov.au/publications/pdf/lessons-from-australian-aid-2013.pdf>

- **Identify the biggest risks that will be associated with the 'Innovation Hub' and any new methods that are developed?**

The central risk associated with innovating for development is that innovations inadvertently cause harm to the poorest and most vulnerable in developing countries. This will occur where innovations are not sufficiently monitored and tested, where they do not adequately respond to the complexities of development challenges or ignore good development practice, existing evidence and lessons learned.

A secondary risk is that innovations developed by the Innovation Hub will fail to have any effect on the intended beneficiaries. Critical to this is ensuring that innovations are developed in line with, and to reflect, the perspectives, knowledge and needs of target beneficiaries, taking into account the particular constraints they face and their local conditions.

There is also a risk that the innovation process will be undertaken inefficiently, and will misuse scarce government resources. This does not refer to ideas or projects that are discarded – these forms of failure are critical to the innovation process provided evidence is gathered and lessons are learned. Rather, we refer to inefficiencies stemming from the poor design of the Hub itself, such as the lack of a clear purpose or objective, an inappropriate attitude to risk, poor monitoring and evaluation processes or a failure to learn from failures, existing evidence or international experience.

To limit these risks, ACFID recommends that the Australian Government support innovation for development through partnerships with stakeholders – whether from the private sector, civil society or academia – who are able to meet upfront due diligence requirements, who understand the complexities of development and have the capacity to implement, monitor, evaluate and learn lessons from past projects.

In forming these partnerships for development, it is also critical that the Government ensures the interests of their development partners are aligned with core development goals.

Question 5:

ACFID indicates that the Australian Government should support innovative solutions by ensuring at least a three to five year timeline of partnership to enable innovative solutions to bear fruit (See 5.1 Innovate, experiment, allow for risk). Could ACFID comment on this in light of the standards outlined in *'Making Performance Count: enhancing the accountability and effectiveness of Australian aid.'*

ACFID recommends the Australian Government consider extending the one-year deadline for aid investments to achieve value-for-money as mandated by the new aid framework.

Making Performance Count: enhancing the accountability and effectiveness of Australian aid details the ten high level targets that will be used to assess the performance of the aid program.

Target 8 stipulates that from 2014-15, 85 per cent of aid investments being implemented will need to meet the new value-for-money principles. Target 8 further states that investments will be cancelled within a year “where value-for-money standards are not met and improvements are not achieved.”

Value-for-money principles are defined by the new aid framework as “cost consciousness, competition, evidence-based decision making, proportionality, performance and risk management, a results focus, experimentation and innovation, and accountability and transparency.”

ACFID welcomes the adoption of a principle-based approach to value for money, which focuses broadly on organisational effectiveness rather than only on cost.

ACFID also supports, and has long advocated for, a focus on effective and quality aid. In our *Benchmarks for an Effective and Accountable Australian Aid Program*, we call for rigorous monitoring and evaluation practices, the use of sound evidence and international best practice, and predictability and transparency within the Australian aid program. These are all principles broadly encapsulated by the concept of value-for-money.

However, ACFID strongly believes that a year is an insufficient period over which to assess the effectiveness and value-for-money of an aid investment. The implementation of an aid program is a complex and difficult task, often contingent on specific conditions on the ground and the characteristics of target beneficiaries. To effectively implement an aid investment, program staff needs sufficient time to monitor the program, tailor it to local conditions, and correct aspects that are not working. Moreover, the role of poor people and communities in defining ‘value’ should be acknowledged and incorporated.

This view is supported by the Australian Government’s Office of Development Effectiveness (ODE) in its recent evaluation of Australian aid to Timor-Leste. The ODE found that the best results were achieved where aid investments had been ‘sustained over long timeframes,

allowing it to evolve in ways that are sympathetic to, and supportive of' local conditions and government policies.¹³ Similarly, in its *Lessons from Australian Aid 2013*, the ODE warned against the use of 'short-term and standalone activities' in the aid program.¹⁴

Moreover, many aid programs aim to address complex issues, such as gender inequality or financial illiteracy, and may take many years before they deliver results. For example, the Pacific Women Shaping Pacific Development initiative, an initiative which crosses a number of government administrations, spans for 10 years in recognition of the time it necessarily takes to shift ingrained gender norms.

The aid framework itself acknowledges the complexities of achieving development outcomes in its commitment to "taking a long term perspective and not declaring 'failure' prematurely – particularly in fragile and conflict settings where development progress is often slow."¹⁵

ACFID believes that Target 8 is particularly incompatible with encouraging innovative solutions to development challenges – a stated goal of the new aid framework. Innovation is inevitably capital intensive, particularly in the early years of program development when research and development costs are high and new ideas need to be trialled and potentially discarded. For example, it may take years to perfect an innovative new farming technique or a new form of mobile technology such that it achieves sufficient economies of scale to be deemed value-for-money.

More broadly, however, innovation requires long and patient timeframes that allow for shifts in direction, for rigorous monitoring and evaluation, and for learning from past mistakes. This view is inline with the private sector's approach to stimulating innovation. Private sector organisations tend to be more comfortable with risk and recognise that innovation may take time to yield results.

ACFID believes that requiring new investments to demonstrate value-for-money in one year may stifle innovation, and also discourage leading innovators from partnering with the government to develop innovative solutions to development challenges. As with any development partner, partnerships with the private sector to enable innovation should be given at least 3 to 5 years to yield results. Ideally, decisions about when to persist with innovative ideas should depend on the nature of the project itself.

¹³ Australian Government, Office of Development Effectiveness, *Evaluation of Australian aid to Timor- Leste*, p4, <http://www.ode.dfat.gov.au/publications/documents/timor-leste-eval-report-2014.pdf>

¹⁴ Australian Government, Office of Development Effectiveness, 2014, *Lessons from Australian Aid: 2013 Report on independent evaluation and quality assurance*, p18, <http://www.ode.dfat.gov.au/publications/pdf/lessons-from-australian-aid-2013.pdf>

¹⁵ Australian Government, *Australian aid: promoting prosperity, reducing poverty, enhancing stability*, p30