



Submission No 14

Inquiry into Australia's aid program in the Pacific

Organisation: Credit Union Foundation Australia

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29 June 2006

Committee Secretary
Inquiry into Australia's aid program in the Pacific
Joint Standing Committee on Foreign Affairs,
Defence and Trade
Department of the House of Representatives
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Dear Committee Secretary

Our organisations welcome the opportunity to provide input to the Inquiry into Australia's aid program in the Pacific. Our formal submission is attached.

Collectively our organisations support, advocate and/or operate a range of microfinance programs in the Asia-Pacific region.

The goal of the Australian aid program is to *'To help developing countries reduce poverty and achieve sustainable development, in line with Australia's national interest'*. Our organisations welcome and endorse the emphasis on poverty reduction and sustainable development, particularly given that two-thirds of the world's poorest people live in our Asia-Pacific neighbourhood. However, in order for the Australian aid program to achieve its goal, our organisations believe that microfinance – the provision of inclusive financial services which includes microenterprise development - is critical to economic development and the reduction of poverty in the Pacific and other developing regions.

We appreciate the opportunity to contribute to the Government's development and continued improvement of its development assistance to the Pacific. We believe that in order to achieve the economic development objectives of the aid program there needs to be an enhanced emphasis on the role of inclusive financial sectors.

Thank you for the opportunity to provide input on this important matter. For more information on this submission please contact either Dr. Paul Greener on (07) 3831 8722 or Peter Mason on (02) 8299 9059.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Mason', is written over a white background.

Peter Mason
Executive Officer
Credit Union Foundation Australia

On behalf of:
Credit Union Foundation Australia
Opportunity International
Rotary Australia World Community Service
World Vision Australia

Foundation for Development Co-operation
Results Australia
World Education Australia

Credit Union Foundation Australia

Foundation for Development Co-operation

Opportunity International

RESULTS Australia

Rotary Australia World Community Service

World Education Australia

World Vision Australia

Submission to the *Joint Standing Committee on Foreign Affairs, Defence and Trade* inquiry into *Australia's aid program and its impact on human rights and security in the Pacific*

1 July 2006

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1. Summary and background

The following organisations welcome the opportunity to provide input to the *Joint Standing Committee on Foreign Affairs, Defence and Trade's* sub-committee on Human Rights inquiry into *Australia's aid program and its impact on human rights and security in the Pacific* (the *Inquiry*):

- Credit Union Foundation Australia (CUFA); the development agency for the Australian credit union sector¹.
- Foundation for Development Co-operation; an independent, non-profit organisation committed to economic advancement and sustainable development in Asia and the Pacific
- Opportunity International; Global not for profit network of MicroFinance Institutions and support organisations.
- RESULTS Australia; a non partisan, volunteer based advocacy group dedicated to generating public and political will to end poverty.
- Rotary Australia World Community Service (RAWCS); Volunteer, non partisan organization committed worldwide to the alleviation of poverty, improvements in health, education, sustainable economic development and promotion of world peace
- World Education Australia; a non-profit development agency that builds the capacity of overseas partners to implement economic development programs.
- World Vision Australia; a non-denominational, Christian humanitarian aid and development agency with a vision of a world that no longer tolerates poverty.

Collectively our organisations support, advocate and/or operate a range of microfinance programs in the Asia-Pacific region.

The goal of the Australian aid program is to *'To help developing countries reduce poverty and achieve sustainable development, in line with Australia's national interest'*. Our organisations welcome and endorse the emphasis on poverty reduction and sustainable development, particularly given that two-thirds of the world's poorest people live in our Asia-Pacific neighbourhood. However, in order for the Australian aid program to achieve its goal, our organisations believe that **microfinance** – the provision of inclusive financial services which includes microenterprise development - is critical to economic development and the reduction of poverty in the Pacific and other developing regions.

Access to financial and non financial services should be considered a basic service the same as access to health services, clean water and education. Without access to affordable credit, a safe place to save etc, the poor will continue to remain under or unemployed, vulnerable to income shocks and insecure in their family and community environment.

A recent World Bank report² found a strong correlation between low incomes and a lack of access to financial services. We support this conclusion and believe that

¹ There are 149 credit unions operating across Australia servicing over 3.6 million members and with collective assets of over \$33 billion.

well-developed financial systems are critical to economic development and the reduction of poverty. Further, we believe that dedicated microfinance institutions can best undertake the provision of financial services to some of the poorest in the region.

Microfinance – the provision of appropriate savings, credit, insurance and fund transfer services and financial training and education to low-income families - can assist these families to increase their incomes and reduce vulnerability to economic and other shocks, and replace their reliance on government support with their own resources and capabilities. Microfinance also provides families and individuals with access to basic services. In this context, microfinance refers to financial services such as credit; savings, insurances (e.g. health, life, livestock, natural disaster insurance) and money transfer services (e.g. remittances). These services are typically provided to low-income consumers who otherwise lack access (through exclusion or unavailability) to such services from mainstream financial institutions. It offers a mechanism for the poor to climb out of poverty, engage in their local economy and invest in their future.

It should be recognised that the Australian aid program is supplemented, augmented and accompanied by a range of private-sector initiatives (including those of the informal sector). A key deliverable of these private-sector participants is the provision of **microfinance** which can be just as vital to the livelihoods and overall economic growth and security of countries and communities in need in the region. For example, CUFA plays a role, in behalf of the credit union sector, in promoting and facilitating microfinance programs across the region to those in need. Similarly World Education Australia provides training and capacity building support to private sector, government and non-profit agencies to extend financial services to poor families and micro-enterprises. Rotary provides funding, training and fully audited programs of microfinance in co-operation with local authorities throughout the world.

In recent weeks, the Foundation for Development Cooperation helped launch Microfinance Pasifika - an alliance of institutions committed to supporting disadvantaged people in the Pacific to improve their quality of life, through the provision of inclusive and sustainable financial services such as savings, credit, remittances and payment services and insurance. The Network was formally launched on 16 and 17 of June 2006 in Port Vila, Vanuatu. It comprises over 20 diverse organisations, including private and state-owned commercial and development banks, specialist Microfinance Institutions (MFIs), credit unions, NGOs, national policy making bodies and microfinance support organisations. The Network will provide a hub to facilitate information flow between microfinance providers, support institutions and government bodies, and challenge member practitioners to new levels of excellence.

With particular regard to the delivery of microfinance, this submission deals with the following terms of reference:

- improving economic management and public accountability institutions;
- maintaining access to basic services;

² Beck, Thorsten, Asli Demirguc-Kunt and Ross Levine, 2004, "[Finance, Inequality and Poverty: Cross-Country Evidence](#)," World Bank Policy Research Working Paper

- anti-corruption and good governance measures; and
- supporting peace-building and community and civil society development.

We believe that Australia should devote more of its aid resources to the promotion of more inclusive financial sectors in the Pacific countries in which it operates. This requires working with government agencies, the private sector and community-based organisations to extend financial services to poor and very poor families and the informal economy. Together with other economic development initiatives this will provide a foundation for genuinely broad based, equitable economic growth.

We raised these and other matters in presentations to the Joint Standing Committee on Foreign Affairs, Defence and Trade, and AusAID in June 2005. In November 2005 we also submitted a Concept Paper for an AusAID Regional Microfinance Support Facility to the Foreign Minister and Parliamentary Secretary.

This submission proposes a microfinance support facility that would provide a central method for AusAID to expand the outreach of poverty-targeted financial services in the Asia-Pacific region. The proposed facility provides targeted support to emerging and expanding microfinance institutions (MFIs) that have potential for growth and sustainability.

The signatories to this submission believe that the concept which is outlined in this Concept Paper addresses the Inquiry's focus on: Strengthening law and justice; Improving economic management and public accountability institutions; Maintaining access to basic services; Anti-corruption and good governance measures; and Supporting peace-building and community and civil society development. The microfinance support facility concept will offer AusAID a useful mechanism to achieve Australia aid program goal *'To help developing countries reduce poverty and achieve sustainable development'*. Further to this, the new Microfinance Pasifika Network, of which the majority of microfinance providers and support organisations in the Pacific are members, will help by providing a manageable point of contact with the microfinance industry in the region.

We acknowledge that many of these matters remain the subject of ongoing discussion and debate within Government. We appreciate and strongly endorse the consultative process and will continue to contribute to these constructive processes.

2. Improving economic management and public accountability institutions

We believe the development of inclusive financial sectors which meet the needs of the poor as well as the non-poor is necessary to improving the economic management and accountability of governments and institutions.

Stable, prudent and responsible institutions in the region will be able to provide a stronger enabling environment for private sector organisations that wish to provide financial and local economic development services.

Possible support could include:

- The overall policy environment for economic development, both specific to the financial sector and in ancillary areas of relevance to economic growth. This would include market-friendly reforms, reduction in “red tape” and policies that promote local value addition;
- A flexible approach to the regulatory and supervisory environment for microfinance. We note that in many developing countries only formal financial institutions serving the top-end of the market fall under the regulatory and supervisory remit. While in some cases this is appropriate, there is also much that can be done in the regulatory environment to provide incentives to improve the professionalism of the microfinance market, which includes the protection of consumers especially in terms of poor people’s savings;
- Support for local economic infrastructure, including rural roads and communications, electricity, local markets etc that stimulate economic activity. Improved physical and communications infrastructure directly enhances the competitiveness of micro-enterprises and facilitates the delivery of microfinance and other community-driven initiatives; and
- Support to the “demand side” for financial services, including small business development, market development, agriculture and rural development and support to literacy and social services in poor areas that build the capacity of people to engage in economic activities.

AusAID already provides this type of support through existing country program mechanisms, however direct support to the financial sector is limited. We are advocating the reallocation and focusing of some of AusAID’s resources to those areas and activities that can produce the most benefit for the largest numbers of people.

However, these types of interventions are not sufficient on their own. We urge the Inquiry to consider the range of measures outlined in this submission collectively when assessing how best to promote more inclusive financial sectors in the region.

3. Maintaining access to basic services

Over the past two decades microfinance programs have demonstrated effective, efficient and sustainable methods of providing essential financial services to poor households, which ensures they have the purchasing power to access other basic services such as health and education. For example, numerous studies point to better health outcomes and higher school participation rates for children of clients versus non-clients.³ Microfinance offers a means of engaging poor households as active participants in market-based systems, in which they have their own demands and obligations, and that enable them to integrate into and contribute to the broader economy.

In this environment, these once-vulnerable consumers can be viewed as clients rather than as mere beneficiaries. Effective and appropriate financial services can therefore have multiple flow-on benefits for the poor, with quantifiable impacts on health, education, housing, skills, confidence, status and well-being. It is these

³ CGAP Focus Note Number 24 January 2003 ‘Is Microfinance an effective strategy to reach the Millennium Development Goals?’

flow-on effects that enable once-poor households to reduce their vulnerability and reliance on government-driven services and to lift themselves out of poverty⁴.

When low-income families do not have access to appropriate financial services, anticipated economic stresses (such as weddings, schooling or medical expenses) and unanticipated ones (such as sickness, crop failure, adverse weather or the death of a breadwinner) become significantly more difficult or impossible to manage. Important resources in these critical times can include accumulated savings, access to credit, insurance and remittances by family members. A lack of access to such resources can lead to indebtedness to moneylenders or other opportunistic lenders that charge crippling interest rates, or a reduced ability to purchase essential items such as medicines, basic foods, access schooling, purchase clothing or much-needed household repairs or improvements.

Each of these factors can in turn lead families deeper into the devastating cycle of poverty. For example, an ongoing inability to access savings and credit further limits the ability of the family to reverse its worsening situation by taking advantage of economic opportunities – such as investment in next season’s crops, a micro-enterprise, or transport and accommodation fees to take up a job opportunity.

Given that there exists a variety of social, cultural, economic and geographic commonalities across the region, there is potential for AusAID to develop a coherent program of activities to promote inclusive financial sectors. This would enable the lessons learned from one activity to feed more directly into the ongoing development of others, and enable AusAID to provide more specialized and dedicated support to the sector. The program could comprise a range of activities spanning research, policy, regulation, private sector and community support initiatives. One of the areas where AusAID would make a significant difference to programs already operating, enabling flow on effects to other activities

4. Anti-corruption and good governance measures

The organisations have observed that the development of a credible and effective microfinance sector is typically accompanied by the emergence of related capacity-building and technical support by local institutions and governments. These corollary measures address, in part, concerns about corruption by imposing additional scrutiny and controls over decision-making and accountability.

Many microfinance initiatives bring with them a range of benefits such as best practice accounting requirements, risk management standards, staff training measures, technical assistance and legislative and regulatory compliance procedures. In combination these factors add to the strength of the microfinance program and make such programs harder to distort or abuse.

Some further examples include:

- institutional and organisational development support to build appropriate institutional structures, systems and products;

⁴ For studies on the impacts of microfinance refer to the library section of the Microfinance Gateway: www.microfinancegateway.org

- technical support in specific operational areas such as developing appropriate internal control systems, risk management systems, improving governance and ensuring statutory compliance, and with designing and implementing appropriate MIS systems;
- support to develop transparent financial accounting and reporting practices and links to national or international reporting databases or microfinance rating agencies, which can assist MFIs in attracting commercial capital and partners;
- networks and linkages to enable emerging MFIs to learn from other, successful, ones, and to build a “community of practice” in the region;
- action research into emerging areas of practice in the field with potential to greatly increase the quality and outreach of services (for example into the use of new technologies and business models); and
- support to social performance monitoring and impact assessment.

Microfinance is about bottom up, community-based programs. Microfinance generates ‘grass roots governance’ through self-help groups, group lending and the microfinance institutional board structures. The money goes direct to these institutions, not via potentially corrupt or mismanaging governments.

A regional financial sector program would provide opportunities for cross-fertilisation of ideas and approaches across countries and enable government and private sector agencies to link with relevant bodies in their region. Increased interaction and transparency among agencies would have direct benefits in terms of anti-corruption and good governance outcomes.

5. Supporting peace-building and community and civil society development

We have also observed that the provision of microfinance can often lead to excellent rates of return against both financial and developmental criteria. These practical and meaningful outcomes lead directly to the strengthening of the community.

Microfinance offered through a mutual model draws on the local community as both owners and customers. Bringing local families and individuals in as stakeholders enables these people to engage in economic opportunities that are otherwise out of reach and a source of friction and at the same time take a greater stake in the stability of their community. Microfinance also plays a role in post-conflict environments, to rebuild community ties that may have been damaged by war or secular issues.

By comparison, the funds required and the level of donor support is relatively small and low-risk compared to these likely socio-economic returns.

We believe Australia’s aid program should investigate additional ways to support microfinance offered by the private sector in the region. In particular, we urge consideration of a facility that would provide a central method for AusAID to expand the outreach of poverty-targeted financial services in the Asia Pacific region.

The proposed facility could provide targeted support to emerging and expanding microfinance institutions (MFIs) that have potential for growth and sustainability and would further Australia's aid program in its objectives of progressing its impact on human rights and security in the Pacific. Details of the proposed facility are provided in both an annex to this submission as well as a summary in the conclusion to this document.

6. Conclusion

We appreciate the opportunity to contribute to the Government's development and continued improvement of its development assistance to the Pacific. We believe that in order to achieve the economic development objectives of the aid program there needs to be an enhanced emphasis on the role of inclusive financial sectors. Support to the financial sector should take place at a number of levels, including research, policy, regulatory, private sector and community sector. In order to achieve this AusAID should develop a regional program that is dedicated to the promotion of inclusive financial sectors. Some suggestions on how such a program might operate are provided as an annex to this submission along with a short summary of the proposed Microfinance Support Facility following.

7. Summary of the Microfinance Support Facility

The overarching goal: To reduce poverty in the Asia-Pacific region by providing the poor with access to appropriate and sustainable financial services. The primary purpose: To provide a flexible mechanism to assist new, emerging and expanding microfinance institutions (MFIs) in the Asia-Pacific region to achieve sustainability in their operations through access to appropriate capital and capacity building support.

Secondary purposes: Enable AusAID to:

- Strategically plan investments in developing appropriate financial systems and access to financial services;
- Ensure greater consistency in the application of funds in a technically challenging sector;
- Supplement efforts by other agencies, donors and programs, improve coordination and reduce overlap to increase leverage;
- Complement and support efforts of existing microfinance-related programs and funding windows within the overall AusAID program, including bilateral, multi-lateral and ANCP funding, and small scale country-level grant programs;
- Coordinate financial services with related developmental efforts such as in the agriculture, rural and community development spheres; and
- Ensure focused expertise is applied to the microfinance sector

Geographic coverage: The facility will operate in any country in the Asia-Pacific region in which AusAID operates, with a focus on those countries and contexts in which AusAID support can be strategically significant.

Who the facility will work with: The facility will work with MFIs, networks of MFIs and support organisations that target the poor. These may be for-profit or not-for-profit organisations. Government and quasi-government agencies in partner countries would generally not be eligible for support but may be identified and referred to AusAID's bilateral country programs for potential support.

Examples of types of support available through the facility:

Capacity building support to partners

Technical assistance will be provided to MFIs and networks of MFIs to promote sustainability and expand outreach of financial services to the poor. Needs assessments and the design of capacity building support programs will be conducted jointly with partner MFI staff. Funding support might also be provided to cover initial operating losses for those new and emerging microfinance institutions that are able to clearly illustrate plans for financial and institutional sustainability and which have strong potential to achieve these goals. The provision of all support would be staged so that access to subsequent stages of support is contingent upon achievement of specified performance targets. A limited portion of these capacity building funds could be used to finance the establishment of new systems (such as the purchase of management information system software and cash management tools). All capacity building work would be put out to public tender.

Other examples of capacity building support would include:

- joint institutional needs assessments
- improvement of portfolio and risk management systems
- development of costing and pricing tools
- development of social performance monitoring systems
- asset-liability management support, such as improved treasury functions

Concessional loans and/or guarantees for on-lending

Concessional (or so-called 'soft') loans would be available for young MFIs that have achieved a minimum level of scale and efficiency that is sufficient for them to meet repayment obligations but insufficient to access commercial financing. Loans (and indeed grants) would be disbursed in tranches, with provision of the following tranche conditional upon achievement of minimum standards of performance and cooperation. It should also be possible for the facility to provide guarantees to encourage commercial banks in the MFIs' home countries to lend to these institutions. This would help integrate the MFIs into the formal banking sector. Guarantee and concessional loan funds could be administered by either the facility's banking sector partner(s) or by the facility manager.

Grants for on-lending

New or emerging MFIs for whom access to capital for on-lending is a constraint to growth and sustainability, and who do not meet the eligibility requirements of the concessional loan component, will be eligible to apply for a grant for on-lending purposes. These MFIs will be required to meet a range of conditions such as a pro-poor project design and poverty reduction focus, adherence to good governance principles, implementation of an appropriate risk management strategy, realistic plans for financial and institutional sustainability, and an inability to access commercial financing. For those MFIs that are assessed as being close to or eligible to access commercial loans, capacity building support may be used to assist them

to access such loan funding. These funds would be administered by the facility manager. Grants would generally convert into MFI equity. It is also possible that an equity investment could be made through third parties should this be considered appropriate.

Research, information dissemination and policy advice

The facility will conduct or support research and scoping studies to enable it to effectively target its programs based on actual demand. While the bulk of this investigative work is anticipated to be undertaken in the initial period to guide subsequent implementation, this component will also include ongoing performance and impact monitoring and reviews. The facility is a responsive and flexible mechanism based on action research principles, enabling lessons learned to be fed back into the design and operation of the facility. This will: facilitate the documentation of lessons learned; assist in streamlining and improving the efficiency of the microfinance facility; and help develop consistent assessment criteria for the selection of partner MFIs to support. All research and investigation work would also be put out to public tender.

Examples of activities under this component would include:

- scoping and design studies
- identification of partners
- performance monitoring and evaluation
- poverty targeting and impact monitoring
- evaluation, reviews and documentation of lessons learned
- microfinance research into key areas of innovation
- dissemination of lessons learned and international best practice

We look forward to working with DFAT and AusAID as well as policymakers, such as the Joint Standing Committee and the Human Rights Sub-Committee to continue working towards finding solutions to reduce poverty in the Asia-Pacific region.

8. Attachments

Description of Signatories to the Submission

- **Credit Union Foundation Australia (CUFA)**; aims to support people in the Asia Pacific region to develop viable credit unions in their communities, and to advocate savings based cooperative financial models. CUFA currently supports microfinance programs in Fiji, Solomon Islands, Tonga, Papua New Guinea and Tuvalu.
- **Foundation for Development Co-operation**; is an independent, non-profit organisation supporting development activities that contribute to income generation, job creation, small-enterprise development and other self-help activities at the grass roots level in Asia and the Pacific. FDC works in the overlapping fields of microfinance, the use of information and communication technologies for poverty reduction, and support to improved rural livelihoods. FDC advocates an approach to development cooperation that strategically combines the resources of business, civil society, and academia as well as governments at various levels.

- **Opportunity International;** Opportunity International's approach provides emerging entrepreneurs with access to small loans and training that will enable them to start or expand their own businesses. Opportunity's work started as microcredit - the provision of small, collateral-free loans to the poor in developing nations. Over time, this service has been expanded to include a broader range of services such as savings and insurance, all encompassed by the term microfinance.
- **RESULTS Australia;** is a non partisan, volunteer based advocacy group dedicated to generating public and political will to end poverty. RESULTS does not deliver microfinance or any other aid program. However, its lobbying efforts have a strong focus on the critical role of microfinance in poverty reduction and its important role in the Australian aid program. RESULTS Australia is closely associated with the international Microcredit Summit Campaign whose goal, set in 1997 is to provide 175 million of the worlds poorest people, especially women, with access to credit and other financial services by 2015.
- **Rotary Australia World Community Service (RAWCS);** Volunteer, non partisan organization committed worldwide to the alleviation of poverty, improvements in health, education, sustainable economic development and promotion of world peace.
- **World Education Australia;** is a non-profit development agency that builds the capacity of overseas partners to implement economic development programs. World Education Australia operates microfinance programs in Cambodia, Laos, Nepal, Vietnam, Sri Lanka, PNG with an estimated \$250,000 spent in 2005-06 on overseas projects, benefiting 17,800 poor families.
- **World Vision Australia;** is a non-denominational, Christian humanitarian aid and development agency with a vision of a world that no longer tolerates poverty. World Vision is committed to the poor, working with all cultures, faiths and genders to achieve transformation, enabling poor people to take control of and manage their lives. With the support of around 350,000 Australians, World Vision helped almost 12 million people and funded 603 projects in 66 countries in 2005, including work in indigenous communities in Australia. As well as providing relief in emergency situations, World Vision work on long-term development projects with local communities to address the causes of poverty and help them move towards self-sufficiency. Through its advocacy work, World Vision also seeks to address the structural and systemic causes of poverty and injustice.

Concept Paper – AusAID Regional Microfinance Support Facility

Attached

Microfinance Pasifika Network Launch

Attached