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Submission for the Independent Review of Aid Effectiveness

Geographic Focus
The Australian Government's geographical focus for international development should continue to be primarily on the Asian and Pacific regions. India, the country with the greatest needs, is currently significantly under represented.

Despite difficulties facing the Australian Government providing aid funds directly to India there are ways for AusAID assistance to be effectively provided. This could include providing guarantees to help agencies establish social development investment or debt funds. Properly structured there is massive capacity to absorb assistance.

Sectoral focus
The United States' Strategy for Meeting the Millennium Development Goals (July 2010) calls for investment in sustainability and local ownership of sound domestic institutions for the long term.

The five crucial elements of this are:

- promoting broad-based economic growth,
- nurturing well-governed institutions,
- empowering women and girls,
- building sustainable service delivery systems, and
- mitigating shocks.

Socially focussed microfinance can deliver these elements. A comprehensive approach to supporting and promoting microfinance through capable local organisations should be a centrepiece of AusAID's development program. This should be more than grant funding but also include direct investment, loans and the provision of guarantees to encourage Australian individuals to participate in social investment or debt funds. This can help mobilise in-country sources of finance.

As the US report noted (page 10):

> *Sustainable and inclusive growth also requires mobilizing diverse resources, including private capital flows and domestic sources of finance.*

Low income countries
The aid program should focus on low income countries. Concerning microfinance, priorities should be determined by the level of poverty in each country, the existence of general rule of law and a free market.

The UN Human Development Report 2010 found that half of the world's poor as measured by the multi-dimensional poverty index (MPI) was found to be living in South Asia and that there were more poor people were found to be living in eight states of India than in the 26 countries of sub-Saharan Africa combined.

We recommend there be greater focus on directing assistance to India.

Different forms of aid

AusAID primarily provides international aid through grants. The implication is that effective development expenditure is made in the form of grants. Development expenditure in other forms, such as debt or equity, is excluded implying that this is not effective development expenditure. This stance is at odds with leading development thinking.

CGAP (Consultative Group to Assist the Poor) is a leading independent policy and research centre dedicated to advancing financial access for the world's poor. In its publication "Good Practice Guidelines for Funders of Microfinance" (October 2006) CGAP argues that effective funding includes not only grants but also debt and equity. In Part IV, Ensuring Effectiveness of Donors, CGAP argues that it is important to use appropriate instruments. On page 24 under operational guidelines it notes:

> *If possible, use a range of instruments, including grants, loans, loan guarantees and equity, and semi-equity participation in ways that can either complement other funders' instruments or successfully unleash domestic capital markets.*

Providing a balance of different forms of assistance will help increase the effectiveness of aid funding.

We recommend that AusAID considers the progress made in this area in the US by Overseas Private Investment Corporation.

The effectiveness of policies

The support provided through the AusAID NGO Cooperation Program (ANCP) is based on the amount granted to the overseas programs, less certain deductions. Grants are included in Recognised Development Expenditure but all other funding is excluded.

Agencies like Opportunity International Australia provide grants, loans and equity to achieve effective poverty alleviation in India, the Philippines and Indonesia. Grants can help build organisational capacity and loans can fund operations. Equity can form a capital base to attract debt funding from local banks and increase program scale. Loans in the form of subordinated debt can also form a capital base to attract debt funding.

This is reflected in CGAP's document entitled "The Key Principles of Microfinance" which was endorsed by the Group of Eight (G8) in June 2004. Principle 9 states:

> *Donor funds should complement private capital, not compete with it. Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop support infrastructure, and support experimental services and products.*

Australian donors support this approach. Over the last five years less than one third of the funds disbursed by Opportunity International have been in the form of grants. The disbursements in forms other than grants have been in the form of equity, subordinated debt and senior debt.

Another advantage of deploying funds on the form of debt and equity is that the financial support is in a form able to be redeployed to other institutions in the program. This would occur once its catalytic role at the first institution is complete. The funding can then be used to support other institutions in the program and continues working effectively.

The regulatory environment can also influence the form of disbursement. In some countries (including India) the microfinance sector is taxed irrespective of organisational form. Funds provided in the form of grants would be subject to income tax on receipt. The most effective way to build the financial capability of agency partners is to provide social capital, rather than grants.

We recommend that loans and investments to agency partners for the purpose of aid be included in Recognised Development Expenditure. Any loans and investments realised and not retained in the program could reduce future ANCP funding.

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