



FOURTH ITEM ON THE AGENDA

Microfinance and decent work

1. The ILO has a unique approach to microfinance, for several reasons. It has a broader applicability in the ILO than in most other organizations: microfinance is credit for income generation, starting or expanding micro-enterprises; and it is also savings, emergency loans and insurance. Microfinance means services that help the working poor – whether employed or self-employed – to manage risks, stabilize incomes and reduce vulnerability. It empowers the poor to organize themselves and create social capital.¹ Microfinance is a vehicle for different ILO strategic objectives.
2. Secondly, the ILO is based on belief in the economic and financial benefits of social organization: associating economic actors for social advancement – this ILO message resonates powerfully in microfinance. If there is one innovation that microfinance is known for, then it is the replacement of loan collateral by trust and group pressure. Group-lending and similar delivery techniques bring the poor together, give them a voice and influence. In other words: social organization is the basis for financial contracts.
3. Lastly, the ILO looks at financial services, institutions, instruments and policies from a social point of view.² Decent work is, to a considerable extent, determined by what happens in the financial market. Changes in employment and incomes are not a by-product, but part and parcel of the very performance of financial systems. This social lens shapes the ILO's vision of financial systems and services. Indeed, the Philadelphia Declaration expects the ILO to examine the social consequences of financial policies. Tripartitism is an asset in promoting social benefits of finance since constituents can influence policy, for better market access, for more equity.³ The ILO strives to promote

¹ See *Working out of poverty* (ILC, 2003), p. 50.

² See “International labour standards and microfinance: A review”, Social Finance Working Paper No. 20, ILO/Social Finance Programme, Geneva 1998. Instruments contain references to social finance under different headings: coordinating economic, monetary and social policies for employment creation; facilitating access to (cooperative) credit for specific groups (homeworkers, rural workers, self-employed persons) or for specific purposes (workers' housing, public works); enabling the safe remittance of wages and savings to families of specific groups (migrants, seafarers); protecting wage earners and independent producers against usury; eliminating debt bondage and chronic indebtedness among specific groups.

³ Due to imperfections, failures or the complete absence of local financial markets, public policy plays a major role in microfinance, using a variety of instruments, ranging from regulation and supervision, to industry-wide capacity building, to the use of subsidies to create or expand

financial services and policies that create more and better jobs, in short: microfinance for decent work.

4. As the United Nations has declared 2005 the International Year of Microcredit, this paper revisits this rapidly evolving field by first summarizing recent developments in microfinance both within the ILO and externally. The paper then explains the ILO's comparative advantages regarding microfinance and seeks guidance from the Committee on Employment and Social Policy on future priorities and activities.

I. Rationale

5. Microfinance is a tool, not a panacea. Often its impact is greatest, if anchored in other interventions, like monetary, fiscal and labour market policies, market enhancement, improvement in the institutional infrastructure, and human resource development. Microfinance occupies a central place between the market and public policy:
 - it combines poverty reduction with profitability;
 - it creates markets and deepens them; and
 - it accelerates the circulation of resources.
6. Microfinance is not handouts. Many poor possess some form of capital, land, property, and skills; however, they have no formal ownership and hence cannot use it as collateral. Microfinance therefore plays a critical role for introducing contract-based transactions in the informal economy, thus progressively formalizing them.⁴
7. The continued popularity of microfinance in international forums is an opportunity to advance the appreciation of decent work by other organizations. In its interactions with international agencies, the ILO as a global social advocate recalls the need to facilitate access to markets and to share fairly the costs of financial policies.⁵
8. This is also a rapidly evolving field. In the past three years since the Committee's initial discussion in November 2002, numerous activities have taken place, inside the ILO and externally, to warrant a reflection and decision on the ILO's position.

External

9. Globally, recent events have emphasized microfinance as an essential component of market-deepening strategies to fight poverty and social exclusion, whilst enhancing private initiative and entrepreneurship:
 - At the **Stuttgart conference of G8 Labour Ministers** in December 2003, high-income countries recognized microfinance as critical for the passage from unemployment to self-employment.

microfinance institutions (MFIs). While in most instances a "public good" argument, such as access to health or education, can be made to justify non-distorting "smart" subsidies, a strategic view of public policy will avoid negative externalities (see GB.285/13).

⁴ ILC, 2002 resolution concerning decent work and the informal economy, *passim*.

⁵ For example, as a direct response to suggestions made by the Committee in November 2002, the ILO – with support from the Government of France – launched an initiative that links debt relief and microfinance with emphasis on the PRSP process in Africa ("Programme des Finances Solidaires").

- The **G8 Summit at Sea Island** in June 2004 adopted a resolution on the promotion of microfinance, remittances and entrepreneurship.
 - The UNDP's Martin/Zedillo report "**Unleashing entrepreneurship**" identifies access to finance as one of three pillars of entrepreneurship.
 - The United Nations has declared 2005 the **International Year of Microcredit**. This proclamation is an opportunity to recall the fundamental links between capital and labour markets, as highlighted in the **Director-General's Report to the International Labour Conference in 2003**.
 - The ILO joined an inter-agency initiative – with the IMF, World Bank, International Fund for Agricultural Development (IFAD), United Nations Department of Economic and Social Development (UNDESA) and United Nations Capital Development Fund (UNCDF) – on **inclusive financial sector development**, which builds on the Monterrey Consensus; in May 2005, the ILO will host a global meeting on this challenge, sponsored by UNCDF and UNDESA.
 - The **African Union Extraordinary Summit on Employment and Poverty Alleviation** Declaration on Employment and Poverty Alleviation (Ouagadougou, September 2004) identified microfinance as a key strategy.
 - The **Millennium Development Goals** (MDGs) midterm review is due in 2005. The ILO actively participates in inter-agency efforts to mobilize microfinance for the MDGs. The Director-General committed the ILO to strive towards greater aid effectiveness in microfinance.⁶
10. These and other related major international initiatives in 2005 and beyond⁷ are an opportunity for the ILO to further expand partnerships with international and regional financial institutions and to promote its values and instruments for a better understanding and appreciation of decent work.

Internal

11. In November 2002, the Committee strongly endorsed microfinance as a strategy for decent work. It requested the Office to strengthen social partner capacities⁸ and integrate it into its agendas (Global Employment Agenda, informal economy, gender, decent work country programmes, local economic development, extension of social protection, SME development, migration, etc.).
12. Indeed, the Office is just beginning to take advantage of the cross-cutting power of microfinance, which spans decent work. All of the ILO's strategic objectives are – in one way or another – addressed by microfinance.

⁶ GB.285/16, Report of the Working Party on the Social Dimension of Globalization: Accessible capital is a key factor for the attainment of the MDGs. Also see www.cgap.org: Key principles of microfinance.

⁷ G8 hosted by the United Kingdom, the United Kingdom initiative on Africa, the MDGs midterm review, to name but three.

⁸ Some of the key issues included market access, cost of capital and investment, asset formation in the informal economy, property rights and empowerment of women through group-based financing schemes (*Provisional Record* No. 1/9, ILC, 91st Session, June 2003).

Microfinance in the ILO and the strategic objectives ⁹

Title	Location	Approx. cost (US\$)	Link to ILO operational and strategic objectives
ACLEDA network of village banks in post-war situation	Cambodia	3.1 m	1a, 1b, 2c and 3a
INDISCO: funds for income-generation for indigenous communities	Interregional	5.9 m	1a, 1b, 2c
Rural women	United Republic of Tanzania	1.3 m	2a, Gender
Guarantee fund to cover loans to disabled	Kenya	900,000	2a, 2c
Collateral law and collateral substitutes	Interregional	200,000	2a, 4a
Debt bondage	Regional Asia	2.4 m	1a, 1b
Child labour	Asia	12 m	1b, 3a
Wage guarantee funds	Eastern Europe	100,000	4a
Remittances and social partners	Interregional	Under preparation	1a, 1b, 3a, 3b, 4a
Good and bad practices in micro insurance	Interregional	500,000	2a, 3a

13. In February 2003, the ILO was subject to a **peer review** by the Consultative Group to Assist the Poorest (CGAP), a process initiated by the United Kingdom Department for International Development, the World Bank and UNDP.¹⁰ The external reviewers concurred with the Governing Body and recommended a shared vision on pro-poor financial services, a framework approach to resource mobilization, and a strengthened microfinance focal point.¹¹

14. In response to the CGAP review, the Director-General formed an Office-wide Task Force to examine its proposals. Amongst a number of detailed recommendations aimed at strengthening the ILO's work on microfinance, the Task Force identified the need for a short statement of the ILO's specific role and a strategy for extra-budgetary fund brought out by the CGAP review, a major effort in extra-budgetary fund raising is required given the constraints on the regular budget. This in turn will need a convincing rationale of the ILO's comparative advantage in microfinance and its relevance to the goal of decent work for all.

⁹ Adapted from the ILO's "Microfinance portfolio", Social Finance Working Paper, 2001; 1a, 1b and 3a: Reducing the vulnerability of the poor, 2a: Integrating financial and social policies, 2c: Employment creation, 4a: Increasing the capacity of the social partners to provide services and influence processes for social dialogue; and Cross-cutting: Promoting gender equality and empowerment in the world of work.

¹⁰ CGAP is a donor consortium of 28 bi- and multilateral institutions. Its secretariat is at the World Bank.

¹¹ For the full text of the ILO's peer review, and those of other agencies, see the CGAP web site www.cgap.org.

II. Comparative advantages

15. The Task Force identified values that characterize the ILO's involvement in microfinance, values that shape the ILO's comparative advantages: the creation of decent jobs, the reduction of vulnerability and constituency-based work.

Values

- (a) **Poverty alleviation:** Financial services are a means to an end; when properly designed and delivered, they are an effective tool for poverty alleviation.
 - (b) **Rights based:** The ILO believes in equitable, non-discriminatory access. Access to appropriate financial services should be ensured regardless of income levels, gender, religion, employment status or ethnicity.
 - (c) **Sustainable development:** Long-term institutional sustainability matters because it ensures stability in supply to the poor.
 - (d) **Solidarity:** Empowerment has both economic and social components. A member-based approach to extending financial services – such as credit unions and self-help groups – can make poverty reduction more effective.
 - (e) **Demand-driven:** Because of its social mandate, the ILO is concerned about the demand by the poor for specific financial services, the unique needs of men and women, and how they are affected by changes in financial markets, policies and services.
 - (f) **Constituents:** The ILO's social partners have an important role in influencing financial policies and facilitating access to financial services.
 - (g) **Broad view:** Social finance provides unity of approach to a variety of double bottom-line initiatives: microfinance, socially responsible investments, protection against over-indebtedness and migrant worker remittances, to name a few.
 - (h) **Gender-sensitive:** Social finance must include gender-sensitive strategies and interventions, which requires taking into account cultural contexts in which the types of financial services needed may differ for men and for women.
16. Based on these values and given its mandate, structure and experience the ILO has three distinct comparative advantages.

Creation of decent jobs

17. Micro-enterprises or income-generating activities create or sustain jobs for the entrepreneur and family members, and small and medium-sized enterprises (SMEs) create wage employment. Wage and self-employment hinge on access to finance and the capacity to manage it:
- To grow, many enterprises, including cooperatives, need finance; this encompasses credit, guarantees, deposit services, payments, insurance and leasing; their owners and managers also need technical and managerial skills, market information and business development services. The ILO is well positioned to offer advice packages, where appropriate.
 - Through incentive-based eligibility criteria, the providers of financial services can encourage informal enterprises to formalize progressively.

- The ILO is well positioned to promote an enabling environment and the financial architecture necessary to encourage financial institutions to serve job-creating enterprises.
- Local economies often depend on member-based financial institutions, like savings and credit cooperatives and mutuals. The ILO is the only United Nations agency with a dedicated cooperative development programme.
- By expanding financial markets, microfinance opens up self-employment opportunities for women, youth or retrenched workers. In high-income and transition economies, microfinance is a key component of self-employment promotion for the unemployed (see box 1).

Box 1

From unemployment to self-employment in industrialized countries

In 2000, the French Government launched EDEN (Encouragement pour le développement d'entreprises nouvelles (Encouragement for the Development of New Enterprises)), a programme that helps the unemployed to start their own business. EDEN provides collateral-free loans at zero per cent through a variety of channels, public and private. Access to these facilities is determined by eligibility criteria which were defined in the light of ILO work with the French "comité de pilotage".

In Germany, the DtA (Deutsche Ausgleichsbank), a government-owned bank that refinances primary banks for start-up loans, had focused primarily on starters in the high-tech field. After it had participated in the ILO's action research on microfinance for the unemployed, it decided to launch a special facility in this area, providing for an upfront flat grant of €1,500 to banks, to compensate for extra administrative costs. In October 2002, the Government further adopted measures (Ich AG) to ensure full social security coverage for business starters coming out of unemployment, as recommended by the ILO.

Reduction of vulnerability

18. The ILO's mandate covers all workers, especially vulnerable groups, such as child workers and bonded labourers, persons living in a post-crisis situation, and those who lack access to formal social protection. Thus the ILO is well positioned to use social finance as a tool to reduce vulnerability, for example:

- to eliminate bonded labour because it reduces the need for workers to take loans that may lead them into over-indebtedness;
- through savings, emergency loans and insurance, helping poor families to cope with unpredictable expenses and income shocks without having to resort to child labour (see box 2);
- social protection usually does not exist for workers in the informal economy. The ILO has unparalleled expertise with micro insurance, which contributes to the extension of social protection to the excluded by linking communities with public social security schemes and other mechanisms;¹²
- ensuring that financial services reach poor women, particularly those who are heads of households, and help reduce vulnerability for whole families and communities. By enabling them to initiate or expand income-generating activities, microfinance enhances women's self-esteem and their control over financial resources.

¹² At its March 2004 session, the Committee emphasized the role of finance as a strategy to enable the poor to cope with risk.

Box 2

Microfinance to combat child labour in Bangladesh

Microfinance is an important component of many IPEC projects. It contributes to the elimination of child labour in two ways: first, by increasing the income of poor families, parents can afford to send their children to school; second, microfinance reduces the household's vulnerability to income shocks. Saving facilities, emergency credit and insurance services enable the poor to better manage the risk of a temporary income shortfall without having to resort to child labour.

In Bangladesh, IPEC built partnerships with local microfinance institutions, such as the Bangladesh Rural Advancement Committee (BRAC), to deliver financial services to poor households with working children. Through these services the poor also get access to health care, education and business development. The project enabled the poor to undertake new income-generating activities and raised the awareness for hazardous child labour. As most groups were composed of female members, the project also contributed to the empowerment of women. They gained more confidence and had more leverage in the decision-making of the family.

This experience in Bangladesh demonstrates that microfinance enables households with working children to make significant progress in savings as well as in income generation. To achieve that objective, one must consider that microfinance is more effective if it goes beyond the limited time frame of a project. Therefore partnerships with existing financially viable microfinance institutions are most effective.

Constituency-based work

- 19. Governments.** Ministries of labour often manage “social funds”, targeted at vulnerable groups (e.g., laid-off workers, rural workers, school leavers, women-headed households, and people with disabilities). Governments also set the environment for the rule of law, the enforceability of contracts and property rights, all of which contribute to equitable access to financial services. Good governance is a fundamental condition for microfinance to thrive.
- 20. Employers’ organizations.** To promote entrepreneurship and expand their membership, employers’ organizations can provide significant support to enterprises that need access to finance, either directly by providing guarantees, or indirectly by lobbying for an enabling environment that allows for the formalization of informal enterprises.
- 21. Workers’ organizations.** Many unions recognize that financial services are not just for self-employment purposes, but also play a crucial role in providing housing, education and protection to their members. By facilitating access to these financial services at affordable rates – either through worker banks and insurance companies or through strategic partnerships with financial institutions – unions could strengthen membership. Unions have an important role to promote the financial education of members exposed to the risk of over-indebtedness. Furthermore, for workers’ associations in the informal economy, microfinance is an ideal entry point around which to organize members (see box 3).

Box 3

Using financial services to organize the informal economy

Syndicoop, a joint programme of ACTRAV and COOP, demonstrates that the promotion of financial cooperatives is a promising entry point for organizing informal economy workers, and facilitating their upgrading into the mainstream economy.

III. Future directions of Office work

22. In line with these comparative advantages, the ILO should focus on three strategic paths to guide its microfinance work:

- (a) **Knowledge:** The ILO should develop and disseminate an understanding of social finance through research, notably on financial innovations that work for the poor.
- (b) **Advocacy:** The ILO should place social finance high on the international development agenda, examining the impact of financial policies on the poor and defining policy options that integrate the social dimension of finance.
- (c) **Services:** The ILO should strengthen the capacity of governments and social partners to shape gender-sensitive financial policies and deliver (or facilitate access to) demand-driven financial services for the working poor.

23. The Office seeks the Committee's guidance on prioritizing the following possible future actions:

- create decent jobs:
 - collect successful experiences in formalizing ownership in the informal economy to establish property rights, pilot test and disseminate the findings;
 - examine the outcomes of microfinance in self-employment promotion for the unemployed in North America and Western Europe and transfer the lessons to other regions;
 - transform the concept of decent work into a credit allocation tool to assist financial intermediaries with “a double bottom line” (i.e. those that seek to optimize social and financial objectives) to incrementally formalize informal enterprises;
 - in line with the guidelines adopted at the 92nd Session of the International Labour Conference on migration, help constituents to facilitate access to remittances, reduce their costs and risks, and leverage remittances for productive investment;¹³
- reduce vulnerability:
 - roll out to other regions the emerging findings of action research in South and South-East Asia on risk-coping and mitigating techniques for a more stable access to affordable and convenient savings, credit, insurance and payment facilities for workers and the poor;
 - recent efforts to use microfinance to promote core labour standards have been largely ad hoc; a more organized and strategic approach is warranted;

¹³ The annual volume of remittances from the United States to Mexico alone is estimated to be US\$15 billion; remittances are resources that go to the poor directly.

- constituency-based work:
 - assist ministries of labour responsible for social funds to ensure that the intended beneficiaries are effectively reached and the services are provided on a solid and sustainable basis.
 - enhance the capacity of employers’ organizations so that they can take informed positions on financial policies and financial market issues that affect employment and entrepreneurship;
 - use employers’ organizations as a vehicle to increase representation of informal economy operators;
 - ensure the effective dissemination of available microfinance tools to relevant social partner organizations;¹⁴
 - with workers’ organizations in the *formal* economy, initiate pilot schemes to improve access to financial services, e.g. remittance facilities for migrant workers,¹⁵ worker banks and insurance;¹⁶
 - examine the scope of microfinance in the context of wage policies and wage protection; design a programme of information services to protect wage earners against over-indebtedness, as laid down in Convention No. 95;¹⁷
 - with a view to progressively formalizing the *informal* economy, forge alliances with workers’ organizations in the informal economy, using best practice methodologies for microfinance as an entry point based on experiences in Asia and Africa.

24. *The Committee is invited to review the policy approach and operational priorities suggested in the paper and, with a view to mobilizing extra-budgetary funding to support the contribution of microfinance to the Decent Work Agenda, recommend to the Governing Body that the Officers of the Committee draft a short statement of ILO policy, to be submitted to the Governing Body in November 2005.*

Geneva, 28 January 2005.

Point for decision: Paragraph 24.

¹⁴ Some existing tools could be very relevant, such as “Microfinance for self-employment” and “Making guarantee funds work”.

¹⁵ See Service Employees International Union (SEIU) initiative in California www.unionprivilege.org (courtesy of Ana Avendano of AFL/CIO).

¹⁶ Worker banks are a form of financial cooperative whose members are workers (see Japan’s labour banks). This follows up the Promotion of Cooperatives Recommendation, 2002 (No. 193) of ILC, 2002. Moreover, financial cooperatives are special in that they can help other kinds of cooperatives – agricultural, housing and consumer coops – to become viable.

¹⁷ Payroll deduction schemes (Articles 7 to 11). The National Economic Development and Labour Council (NEDLAC) identified this as a major issue in South Africa; in this context, social partners may wish to provide financial education for those at risk of falling into the debt trap.