The Saints Peter and Paul Peace and Social Justice Committee invites you to focus on Catholic Relief Services' MICROFINANCE operations

Earlier this year, as a part of our larger series on Catholic Relief Services (CRS), we provided a brief introduction to CRS' microfinance operations. Now, we begin to bring these operations front-and-center as we focus for the upcoming year on how CRS uses microfinance as a part of its mission "to cherish, preserve and uphold the sacredness and dignity of all human life."

Microfinance is a trendy topic, but it can be confusing, and it is easily misunderstood. Therefore, we begin our series on CRS' microfinance operations with a crash course on microfinance itself. Don't worry—no finance geeks were involved in the creation of this crash course. It was researched and written by the not-so-financially-literate, for the not-so-financially-literate. Please read on.

Financial Inclusion

Perhaps the first and most important concept to understand (before we can talk about microfinance) is *financial inclusion*. According to the Consultative Group to Assist the Poor (CGAP),

> *Financial inclusion means that households and businesses have access and can effectively use appropriate financial services. Such services must be provided responsibly and sustainably, in a well regulated environment.*

"Appropriate financial services" could be any of those we rely on in our first-world society: savings and deposits, loans, remittances and money transfers, and insurance, to name a few. Evidence has shown that greater access to such services is good for both households and the wider economies in which they operate. However, according to World Bank research, it is estimated that more than half of the world's total adult population does not have access to them.

For this other "half" of the world, maintaining a basic level of dignity can be difficult or impossible. Crises and large expenses can be hard enough to manage for those of us who have savings accounts, insurance plans, access to credit, and the ability to move funds electronically with affordable transaction fees. They are all the more devastating to individuals and households without such services. Even if a poor individual or household has managed to put away some money in a jar or invest in something easily exchangeable for cash (like livestock or jewelry), such savings and investments are vulnerable to theft and other casualties, loss of value against market forces and/or inflation, and temptation (all the more powerful in needy circumstances). They can also be difficult to transport in the event one has to flee due to a natural disaster or man-made conflict.

Microfinance

Now, knowing something of the meaning and importance of *financial inclusion*, we can begin to talk about *microfinance*. If greater *financial inclusion* is a goal, *microfinance* is a way (or rather a set of ways) to get there. Again, CGAP provides a good definition:

> *The term "microfinance," once associated almost exclusively with small-value loans to the poor, is now increasingly used to refer to a broad array of products (including payments, savings, and insurance) tailored to meet the particular needs of low-income individuals.*

This definition draws attention to a common misconception about microfinance: many people assume it refers exclusively to "small-value loans to the poor" or are unaware that such loans (which are called *microloans* or *microcredit*) are simply one aspect of microfinance. It is important to think holistically when we think about microfinance because, just like in wealthier populations, not everyone needs a loan. In fact, according to CGAP "Providing credit to those not able to use it productively could push already-vulnerable people into debt."

That said, microcredit is a valuable tool for increasing the welfare of some of the world's poorest citizens. In 2006, Muhammad Yunus and the Grameen Bank won the Nobel Peace Prize "for their efforts to create economic and social development from below" via microcredit. Studies have shown that access to credit can increase the welfare of both households and businesses. In fact, the mere knowledge that credit is available may, according to behavioral research, have a positive impact on household decision-making and increase long-term welfare.

But, we must recognize the need for other financial services as well. The ability to save small amounts of money in a secure location is needed by the poorest households to reduce their vulnerability and work towards gainful investments. Insurance is also needed to help manage risks for businesses, farmers, and households. Affordable money transfer services are needed by many poor people who rely on remittances as a significant source of income, yet currently spend much of that income on the transfer fees associated with the remittance. Financial literacy—although it may not technically be a financial service—is also needed as we work toward greater financial inclusion.

Challenges to Microfinance and Financial Inclusion

Such a great need for financial services invites us to ask why financial services providers have yet to meet these needs. Several challenges stand in the way. In general, it is more costly to a provider to handle several smaller transactions than it is to handle fewer larger transactions. Financial institutions tend to charge higher interest rates on microloans than on regular loans, not necessarily for any malicious or predatory reason, but simply because the operating costs for offering several smaller loans are greater than the operating costs for offering fewer larger loans. For other financial services, there are often minimum transaction amounts that exclude poorer clients. These clients have smaller means and therefore need to deal in smaller amounts—this is where we get the *micro* in *microfinance*. Insurance presents special challenges as it requires just the right mix of individuals in a risk pool in order to succeed.

Other challenges relate to the wider context in which potential clients live. Distance, illiteracy, and/or a lack of reliable identification (such as government-issued photo identification cards) can often be barriers. Governments can also hinder financial inclusion depending on how they regulate activities. A lack of quality infrastructure can make transactions difficult and expensive. Trust and other less tangible factors can be obstacles as well.

Hope for Financial Inclusion

In spite of these obstacles, many organizations and individuals are working to bring appropriate, responsible financial services to those who need them most. CRS is one such organization. Over the next several months, the Peace and Social Justice Committee looks forward to bringing you information and stories about CRS' microfinance operations. Like all of CRS' work, these operations are holistic, culturally sensitive, interconnected with other areas of development work, and have at their heart the dignity and inherent value of the human person.

Please stay with us for what we hope will be an engaging, and inspiring exploration. In the meantime, you can learn more about microfinance and financial inclusion from CGAP. This organization is one of the implementing partners for the G20 Global Partnership for Financial Inclusion, and most of the information above was obtained from CGAP's website, which has a highly informative Frequently Asked Questions page (http://www.cgap.org/about/faq).