

Microfinance in post-disaster and post-conflict situations: Turning victims into shareholders

M. Hudon and H. D. Seibel

In recent years, large numbers of developing and transitional countries have experienced situations of crisis, following political, economic or natural disasters, or total crisis, triggered by war or totalitarian oppression. The goal of this article is to study the role of member-owned institutions (MOIs) in the provision of the reparations for victims of human rights abuses or reconstruction in post-conflict and post-disaster situations. We argue that grants usually awarded for reconstruction in post-conflict areas or for reparations payments in post-disaster areas could be best turned into equity and deposits to foster MOIs. MOIs are found to be an appropriate institutional framework, to make the benefits of one-off payments more sustainable and also reinforce the financial sector.

JEL Classifications: L31, M54, O16, Q14

Keywords: microfinance, conflict, disaster, repayment, human, right

CEB Working Paper N° 07/002
2007

Microfinance in post-disaster and post-conflict situations:
Turning victims into shareholders

Marek Hudon

Harvard University

FNRS Research Fellow - Centre Emile Bernheim, Université Libre de Bruxelles (ULB)

Harvard University, c/o Sue Wood, Byerly Hall

8 Garden Street, Cambridge MA 02138-3654

mhudon@fas.harvard.edu

Hans Dieter Seibel

University of Cologne

Acknowledgment: A later version of this paper will appear in Savings and Development.

Keywords: microfinance, conflict, disaster, repayment, human right

JEL Codes: L31, M54, O16, Q14

Microfinance in post-disaster and post-conflict situations: Turning victims into shareholders

Abstract: In recent years, large numbers of developing and transitional countries have experienced situations of crisis, following political, economic or natural disasters, or total crisis, triggered by war or totalitarian oppression. The goal of this article is to study the role of member-owned institutions (MOIs) in the provision of the reparations for victims of human rights abuses or reconstruction in post-conflict and post-disaster situations. We argue that grants usually awarded for reconstruction in post-conflict areas or for reparations payments in post-disaster areas could be best turned into equity and deposits to foster MOIs. MOIs are found to be an appropriate institutional framework, to make the benefits of one-off payments more sustainable and also reinforce the financial sector.

1. Introduction¹

In recent years, large numbers of developing and transitional countries experienced situations of crisis. These were caused by either political, economic or natural disasters, or total crisis, triggered by war or totalitarian oppression, in which the very structure of society was decommissioned (disrupted? destroyed?). Conflicts and disasters severely affect socio-economic institutions, public governance and the networks and social relationships of citizens, including those pertaining to the exchange or transfer of financial resources

In this paper, we will focus on microfinance institutions (MFIs) owned by their shareholders or members on a self-help basis. These are understood to be small local financial institutions, mostly starting on an informal basis. Member-owned institutions (MOIs) such as local (indigenous) savings and credit associations (ROSCAs, ASCRAs) and cooperatives are far more likely than banks and other formal financial institutions to have survived: either as functioning financial intermediaries or as social capital in the minds of people that can be easily revived as circumstances permit. They can thus play a major role in post-disaster and post-conflict situations where government institutions are absent or discredited. The positioning of member-owned institutions as independent institutions can foster their neutrality and effectiveness in dealing with sustainable recovery and reconstruction. Being member-owned and democratically self-managed, they can also play an important role in the establishment or reconstruction of civil institutions and a democratic society.

The approach presented here applies to poor countries emerging from civil war, total crisis, or repressive regimes as well as to situations where large numbers or clusters of poor people are eligible for reparation payments in the form of compensation. In a similar way it applies to post-conflict and post-disaster situations. It is inspired by a concern for sustainable impact, in two respects:

- (i) Economically, reparation payments which are not invested profitably are easily wasted and may deepen the existing sense of hopelessness. Investing them in MOIs creates a source of funding and initiates a process of sustainable growth from profits generated: growth of the recipients of reparation payments investing

¹ This paper is based on a presentation at a conference in Bellagio on “Repairing the Past: Reparations and Transitions to Democracy,” sponsored by the International Center for Transitional Justice, New York, in 2003. A revised version, with Andrea Armstrong, was published in the Handbook of Reparations, edited by Pablo de Greiff, 2006. In this paper Hudon and Seibel take a wider perspective, covering both post-conflict and post-disaster situations.

the loans received from their MFIs; and growth of the MFIs which finance the recipients-turned-microentrepreneurs.

- (ii) Politically, investing reparation payments in MOIs creates ownership and control of institutions; this is fundamental to any democratic or democratising country and ultimately far more important than ownership of things material.

In Germany, and similarly in other countries in Europe, microfinance emerged during the 18th and 19th century from informal beginnings under conditions of extreme poverty; the resulting savings and cooperative banks now account for around 50% of banking assets in Germany (Seibel, 2003).

There is some experience with microfinance in post-conflict situations (Ahmed, 2000; IMF, 2000; Gupta et al., 2002; Ohanyan, 2002) but as far as we know, there is none with microfinance and reparation payments, be it with the use of MFIs as an instrument to maximize the benefits of reparations in a sustainable way or with the use of reparations in building MOIs as instruments in the transition to a market-based political economy and democratic order. Of course, microfinance is not a panacea and does not work in all situations (Lietaer and Hudon, *forthcoming*). MFIs as civil institutions, particularly when owned and controlled by their members, form part of an evolving civil society; but they alone will not bring about the devolution of power, democracy and a market economy.

The goal of this article is to study the place of MOIs in post-disaster and post-conflict situations. Reparations for victims of human rights abuses are presented as a concrete example of possible involvement of microfinance in these contexts. The two main research questions we will focus on are thus: how could reparation payments be possibly put as equity into MFIs and how could we suggest to deposit them as savings if the NGOs are not authorized to accept deposits?

Section 2 will analyse the microfinance sector, first in post-conflict and then in post-disaster areas. Section 3 will then concentrate on the special case of civil right abuses and the reparation payments related to the abuses. The final section will present some conclusion to be drawn from the evidence presented.

2. MFIs in post-conflict or post-disaster situations

Years of conflict or natural disasters both result in a decline in the quality of life and economic well-being. In situation of total crisis, the state virtually ceases to exist, national

economies disintegrate, and social and political structures disappear. International aid projects first aim at helping the population to survive periods of immediate danger of disease and starvation. When the immediate threat is over, the phase of reconstruction commences. Reconstruction and institutional rehabilitation mark the transition from an emergency to a development situation, geared to the emergence and strengthening of a democratic order and a market economy. Microfinance, as a system of self-reliant local financial institutions can play a crucial role in the transition from relief to reconstruction and sustainable development. (De Greiff 2006; Seibel 2006)

There is a consensus that conflict's impact on most economic variables such as fiscal measures tend to deteriorate as conflict intensifies. Furthermore, the instable macro-economic framework also affects business activities. Countries affected by conflict exhibit much higher inflation. Even if inflation decreases at the end of the conflict, countries often exhibit higher inflation rate than before the conflict (Gupta et al., 2002).

Conflicts affect fiscal policies by disrupting economic activity, lowering the tax collection efficiency (Ohanian, 2002) and affecting the composition of public spending (Gupta et al., 2002). Increase of military spending in conflict situation therefore often results in reduction of spending on productive activities.

At the same time, many other events occur: institutional capacity for policy decisions and planning at national level has been eliminated or curtailed; communities and informal or traditional institutions have been detached from the broader society and markets; household economies have reverted to subsistence and survival strategies; large numbers of individuals have been physically and socially displaced and were subject to traumatizing experiences of violence. All this creates immense problems for rehabilitation and reconstruction.

Ahmed (2000) also found that the absence of formal financial institutions discourages deposits and makes lending more difficult. Existing institutions lose their clientele who are often defaulting. In Liberia, for instance, 78% of the loans of commercial banks were classified as non-performing loans two years after the cessation of fighting (IMF, 2000).

Ohanian (2002) explains that two conflicting approaches have been applied in the post-conflict Bosnia-Herzegovina. The first one sees microfinance as an immediate peace-building instrument targeting some population and offering financial services to these specific clients. This approach is favoured by humanitarian organizations which may use it to reintegrate

minorities. It aims at offering a social safety net and minimizing the social cost of transition. It can however polarize the community.

The second approach is a more commercial one. It focuses on the long-term sustainability of the microfinance institutions in case donor agencies withdraw. The target is then the economically active poor with business skills. This position is for instance held by the Consultative Group to Assist the Poor (CGAP), a consortium of 33 public and private development agencies. It insists that the core principles of microfinance, such as maintaining high portfolio quality, applying market interest rates, and planning for full cost recovery, should not be compromised (CGAP, 2004); targeted programs should be avoided. One limitation of a fully-fledged microfinance approach in post-conflict situations is the market size of clients with business skills, their lack of assets, the breakdown of existing markets, and the uncertainty created by physical insecurity (McVay, 2005).

Moreover, surviving institutions are often reluctant to give loans and hold excessive liquidity. They are also primarily active in the big cities. In the Democratic Republic of Congo, for instance, only around 35 000 bank accounts existed at the end of 2004, for a population of approximately 55 million inhabitants. Their operations were mostly limited to financing trade and foreign exchange in hard currency. These clients are served by ten commercial banks with only one bank branch for every 2.4million inhabitants (OECD, 2005). There is a large gap left by formal banks that may be filled by decentralized financial institutions.

Sierra Leone is an example of the management challenges and financial constraint faced by the microfinance sector in post-conflict countries. While major improvements have been made on political or macroeconomic issues, most microfinance institutions remain weak (CGAP, 2002).

For instance, *susu* or *osusu*, rotating savings and credit associations, are very popular in Sierra Leone as instruments to save for medical expenses, bride price, school fees or business expenditure. Financial discipline is enforced by the members of the group who may claim any part of a defaulter's assets. Nevertheless, the low-income of most members is a major limitation. Amounts of funds mobilized are often not sufficient to generate significant funds (Kooi and Tucker, 2003). The term microfinance is also sometimes misused or mislabelled, for instance for quick cash disbursement through an informal structure. These schemes involve grant disbursement and do not put much emphasis on repayment collections and institutional development (CGAP, 2002). This misunderstanding can also affect MFIs since MFIs' customers and all potential customers may confuse credit and grant.

Similar to post-conflict situations, the core task of public policies in post-disaster areas is the reconstruction of basic political, economic and social institutions which are essential to the functioning of a society. One critical factor in remote areas affected by disasters is the proportion of self-employment. A joint GTZ/KfW survey after the 2004 tsunami in the province of Aceh in Indonesia divided the population in three segments (Hammerich et al., 2005):

- a) People most affected by the tsunami who presently live in tents/barracks or host families and lost all or most of their assets. They are totally depending on direct assistance provided by the government and donors.
- b) People partly affected by the tsunami who lost only parts of their assets and are ready to restart income generating activities, but presently lack access to financial services. Many representatives of this group are traders and SMEs.
- c) People indirectly affected by the tsunami. This includes, for instance, host families, who need access to capital to expand economic activities to meet higher living costs; and people who lost their savings because their cooperative was swept away.

One may also differentiate countries where disasters are regular, such as Bangladesh, with the river bank erosions, cyclones or floods, from others where situations are less predictable, such as the tsunami in Indonesia. For instance, on average, Bangladesh is hit by cyclones of varying intensity two or three times a year (Matin and Taher, 2001).

In countries where disasters are less frequent, the situation is different. In Aceh 70% of the population were self-employed before the tsunami. 600,000 people, 36% of the working population, lost their source of living, mainly in the agricultural sector (60%), the fishery sector (21%) and unregistered small businesses (28%) (ILO, 2005). While credit access is still a main constrain in these countries, it worsens dramatically in time of disaster.

From a client perspective, access to credit may be more difficult since their creditworthiness has often worsened in post-disaster or post-conflict situations. Winchester (2000) found that the two key attributes to reduce vulnerability of the poor are an established income and their creditworthiness. Many entrepreneurs loose their market because of the disaster, and thereby any established income. Furthermore, many financial institutions have seen their credit record files destroyed during disasters, such as in India after the tsunami. When they occur in institutions reaching poor people, these loose credit history and creditworthiness for this

population. Borrowers who had access to more formal institutions may also have lost any sort of collateral required.

In most post-crisis situations, MFIs are the major agencies providing financial services. As in many cases, they are capitalized by donor agencies: international NGOs, bilateral or multilateral agencies. They provide microcredit and rudimentary savings services, usually in the form of compulsory savings as part of the credit package. They are also easily and quickly established and do not require a complex legal framework, which is a major impediment for commercial banks in many developing countries. Given their orientation to poor target groups, they are able to communicate with the poor and distressed who are particularly affected by the destructions. Finally, they are flexible in providing a range of services, in addition to finance such as microenterprise training and consultancy services.

While this broad orientation may be appropriate in the immediate post-crisis situation, as the situation consolidates, some NGOs specialised in microfinance consider that, if they want to handle finance well, they better specialize on that, leaving microenterprise development, education and health care to other agencies. An example of the spectacular proliferation of credit NGOs is Uganda, where after the elimination of the country's human and social capital through murder and repression by the regimes of Idi Amin and Milton Obote (1972-1986), some 400-500 credit NGOs emerged more or less within a decade, during the late 1980s and 1990s.

In a survey of the Divi Seema area in India, Winchester (2000) considers NGOs as an alternative approach to the bad record of the government resource allocation in post-disaster situations. In this case, the size of the NGO seems to be a critical factor in its effectiveness in tackling the cause of poverty. Only large NGOs were able to have significant effects. Clearly, in both cases, the interaction with the governments is a crucial success factor.

3. The challenge of the sustainable impact of reparation payments for civil rights abuses

We will now turn to a specific case in post-conflict or post-disasters situations: reparation payments for civil rights abuses, defined as "action or processes that repair, make amends, or compensate for damages" Johnston (2000: p. 51).. There are three principal forms of reparation: restitution, indemnity (or compensation), and satisfaction.

According to the United Nations Universal Declaration on Human Rights, “Everyone has the right to an effective remedy by the competent national tribunals for acts violating the fundamental rights granted him by the constitution or by law” (Article 8). The Declaration further specifies that “the Court shall establish principles relating to reparations to, or in respect of, victims, including restitution, compensation and rehabilitation” (Article 75). Awards for reparations may be deposited in a Trust Fund (Rule 98) (de Greiff, 2003: pp. 5-6). The emphasis in this paper is on material reparations, or compensations, which benefit the victims directly.

On this legal basis, the International Center for Transitional Justice (ICTJ) assists countries pursuing accountability for mass atrocity or human rights abuse. Among the key elements on which the ICTJ focuses are promoting reconciliation and providing reparations to victims of civil rights abuse: a relatively neglected field relative to the emphasis placed on prosecutions (de Greiff 2003). Given its commitment to building local capacity and generally strengthening the emerging field of transitional justice, ICTJ faces the challenge of how to build local capacity in such a way that reparation payments have a lasting impact on the well-being of the victims and their families.

MFIs might be instrumental in providing an institutional framework for sustainable impact on recipients of reparation payments in three ways:

- by offering a secure place for the safe-keeping and accumulation of reparation payments and savings, thereby strengthening the self-financing capacity of the recipients of reparation payments and other depositors;
- by offering credit for investments and working capital to small and microentrepreneurs and attracting external finance of increasing size ;
- by offering recipients of reparations the opportunity of building MFIs, thereby mobilizing the self-help capacity of the victims as shareholder-owners and users, particularly in situations where no functioning institutions exist.

The basic logic would be the same for reconstruction support (perhaps with an incipient minor component during the relief stage, to get the process going) and for reparations payments. Of course, depositing or investing reparation benefits in MFIs involves the risk of failure. However, this applies equally to commercial banks, which have periodically collapsed in many developing countries, as well as to a number of countries, which have gone through

hyperinflation and even the collapse of their monetary system. Banks and monetary systems are beyond the control of recipients of reparation benefits. MFIs have at least the advantage of direct control of the owner-beneficiaries over their operations. However, this does raise the issue of prudential regulation and supervision of large numbers of small institutions, which is in fact not satisfactorily resolved as yet in most developing countries, and virtually never in post-crisis situations.²

This deposit policy might also serve MFIs, and prevent from bankrupt and additional systemic risk of collapse of the financial sector. Indeed, one of the major risk MFIs face in post-disaster situations is the clients' rush to withdraw their savings. For instance, in Bangladesh, small MFIs were several times put in risk after floods and unable to maintain necessary levels of capitalization. Less prepared MFIs have therefore been casualties of the disasters they had to mitigate against (UNDP and World Bank, 2000).

MFIs could also go a step further and convert benefit payments into shares and beneficiaries into shareholders of MFIs, thereby turning the former victims into owners or co-owners of local institutions, with full access to their services as an additional inducement.

In the first case, reparation benefits can be fully paid to the victims, thus maximizing individual autonomy. In this second case, they might have to be divided into individual benefits and collective investments into institution building – unless other donors would step in and finance the institution building, which is quite likely to be the case.³

Whether the payment of reparation benefits on a broad scale would make use of existing MFIs, in which the beneficiaries would be new customers or new co-owners, or lead to the establishment of new MFIs with the beneficiaries as initiators, would depend on the situation in a country and on the decisions of all concerned, particularly the recipients themselves.

As there is, to our knowledge, no precedent in bringing together reparation payments and microfinance, the following deliberations are based on our experience with microfinance⁴, not

² Suffice it to say in this limited space that many developed and some developing countries have solved the problem through delegated supervision by auditing federations as apex organizations of networks of financial institutions, under the ultimate authority of the bank superintendency.

³ Eg, when writing the first draft of this paper, the feasibility of establishing MFIs in Iraq along a model tested in Syria was discussed. The question whether all or part of reparation payments would have to be used for institution building has meanwhile been settled: In December 2003, the International Finance Corporation of the World Bank Group announced the allocation of resources for a microfinance facility of up to \$200 million, including \$30 million for capacity building. In a similar vein but on a smaller scale, Sierra Leone is now receiving additional resources of a considerable magnitude for establishing MFIs. It appears that once a promising approach is presented, additional funds for equity and institution building can be found.

⁴ The authors' personal experience in developing countries is limited to Africa, South and Southeast Asia, and the Middle East.

with reparation payments or other ways of remedying civil rights abuses. Moreover, there is no single *best-practice* model that fits all. In each individual case, one has to (i) study the local situation, (ii) examine the international experience, (iii) involve stakeholders, and (iv) jointly arrive at an appropriate approach, (v) which must be continually monitored and (vi) revised as seen fit. Eg, both women and men will be involved as beneficiaries-turned-owners or beneficiaries-turned-MFI clients; but how they share or divide ownership and control is up to them to decide. Respect for local autonomy is crucial.

4. From relief to institutional rehabilitation and development: A framework for reparation payments

Reparation payments should be designed in such a way that their impact survives the transition from emergency aid to rehabilitation and sustainable development. Rehabilitation from crisis can be used as a window of opportunity for strategic policy changes; therefore, reparation and rehabilitation programs need to identify those strategic policy changes and support them.

Many cases have shown that there is room for reviving institutions of the civil society which were formerly repressed, restricted or ignored; research to unearth these institutions and to assess their potential for institutional upgrading should underpin planning.

Self-help is the backbone of any war and post-war economy and might play a similar role during rehabilitation; research is needed to assess the potential of self-help for institutional rehabilitation and of linkages between self-help efforts, reparation payments and rehabilitation. Programme ownership is critical for the impact of aid; support to community-based organizations is more appropriate than targeted reparation programs.

Rehabilitation programs can play a crucial role in supporting local capacity for rehabilitation; needs assessment and focused capacity-building analysis should be part of reparation and rehabilitation programs. Therefore, practical solutions to the bottom-up vs. top-down dilemma are critical for sustainability; societies may differ widely in their cultural capacity for participatory vs. authoritative decision-making.

There appear to be four major ways of carrying out reparation payments:

- (1) Direct payment through specialized agencies
- (2) Payment through commercial banks
- (3) Payment through NGOs
- (4) Investment in local financial institutions (co-) owned by recipients of reparation payments.

The likelihood of sustainable impact of reparations on the life and well-being of recipients depends on how payments are transacted, increasing from (1) to (4) on the scale above. Profitable investment of payments in income-generating activities⁵ can foster the chance for a sustainable impact. Direct payments through specialized agencies may have some positive impact in individual cases (likely to be reported as success stories), but are unlikely to substantially and durably benefit a larger number of recipients. Chances of sustainable impact may improve somewhat if payments are administered through commercial banks, which are usually among the first institutions re-established after a crisis. If the beneficiaries are required to open a bank account first and payment is made through this account, there is a modest chance that this might lead to a lasting bank relationship. In this case, some other agency would have to provide training and consultancy services to guide the beneficiaries in their banking relations as well as in their investments. However, exceptions notwithstanding⁶, few commercial banks have shown an inclination of dealing with small customers; to the contrary, many erect formal and informal barriers to keep them away, eg, through sizeable minimum deposits and unfriendly treatment.

From NGOs to member-owned types of local financial institutions

Some of the strengths of the NGOs doing microfinance in post-conflict and disaster areas are also their weaknesses. For instance, while easily established in a legal void, they lack the legal status of a financial institution and tend to feel quite comfortable with donor support and the absence of regulation and supervision. NGOs have no clear ownership, rarely if ever the legal status of a regulated and supervised financial institution. Experience in many countries has shown that without an appropriate institutional framework, the benefits of one-off payments either for relief or as reparations tend to be short-lived and unsustainable. As credit NGOs,

⁵ Payments may also be invested in housing, either as a source of rental income or, given the fungibility of money, freeing other income for profitable investments,

⁶ The Commercial Bank of Sierra Leone might turn out to be such an exception, as it is reportedly making preparations for a new window for small loans (ARC 2002: p. 2).

they are not authorized to mobilize savings, at least not beyond a certain level, and may not feel the need to do so if they have a generous donor. Donor dependency and lack of self-reliance in terms of funds have two repercussions: lack of viability (with operational self-sufficiency rates frequently far below 100%); and lack of growth of outreach, which would require rapidly increasing internal resources, derived from savings and retained earnings. Subsidised institutions not aiming at operational sustainability, even on the long run, can put their clients at risk if donors withdraw their support.

Local financial institutions owned and controlled by the people, after being trained in book-keeping and financial management, are among the basic building blocks of civil society. In many countries, self-help groups and indigenous informal savings and credit associations are the only civil society institutions which have survived the breakdown of society. They represent the social capital for the reconstruction of local financial institutions. Social capital is defined here as the shared normative system of a group or organization which shapes the capacity of people to work together and produce results according to the group's or organization's purpose (Quinones and Seibel, 2001).

In other countries, such institutions have to be newly built. In either case, experienced international NGOs may be instrumental in building or reconstructing MFIs owned or co-owned by recipients of reparation payments. Part of the funding in a reparation program has thus to be allocated, as individual compensation, directly to the victims-turned-shareholders, the other part, as a collective measure, to institution building. Based on satisfactory performance of the MFI, the share capital may be augmented by donor grants and bank borrowings to increase the volume of loans to the user-owners for their income-generating activities. Experience has shown that networks of such institutions can be successfully built within 2-3 years; sustainability in terms of self-management, self-financing and legal framework of the MFIs and their network may take another five years. In terms of sustainable impact, there is no alternative to institution building!

A different approach, with ownership clearly established from the onset, would be support to locally owned financial institutions, which may be (co-) owned by recipients of reparation payments. These are mostly small local institutions, which are flexible and adaptive. Because of their institutional size, their sole business is microfinance. They may be formal, semiformal or informal, or combine two levels, as in the case of a village bank with a surrounding network of informal savings and credit associations as retailers. They may have great

evolutionary potential: from informal to semiformal, from semiformal to formal, and from unit banking to branching-out.

Different types of locally owned institutions exist. The best known case is the MOIs that are based on social solidarity (de Greiff, 2003) and are typically self-financed and self-managed. They can be formed by any type and number of people within or across neighbouring communities, comprising microentrepreneurs, small farmers, women and the poor.

Membership is normally contingent upon an equity capital contribution; but they may also be *exclusive* institutions be restricted to women or traders on a market.. In some cases such institutions are also open to non-members but on different terms. MOIs rely fully or largely on their own resources, i.e. on savings and equity including retained earnings. Equity contributions (shares) may be equal (as in formal cooperatives) or unequal (as in most indigenous savings and credit associations and in the FSA presented below); similarly, votes may be equal or tied to voting shares. Among the financially self-reliant institutions owned by their members are vast numbers of group-based informal financial institutions. Among them are the ubiquitous rotating and non-rotating savings and credit associations. Whether nonformal institutions can evolve into banks depends on the legal framework, which is of course subject to change.

Community-owned financial institutions may be people- or local government-based. They are people-based if the members of the community are either directly (through individual or household membership) or corporately owners of the institution, as in the case of the LPD in Bali. There must be a provision in the rules and regulations or bye-laws that the community members or its recognized representatives have a say in the running of their affairs. This should also be reflected in the perceptions of the people, who should consider the institutions as theirs. In some developing countries community banks are local government-owned, as in the case of the BKK in Central Java. In fact the dividing line between institutions owned by local government or by the people of the community is not always sharply drawn and may be as much a legal as a social issue. A useful quantitative indicator may be the extent to which community banks depend on government resources vs. savings and retained earnings as a source of funds.

Other sorts of locally owned institutions are the privately owned financial institutions. These are owned by one or several wealthier individuals. Examples are the rural and community banks in the Philippines, Indonesia and Nigeria. Sometimes they are owned by large numbers

of not-so-wealthy individuals, with shares similar in size to those in cooperatives. The difference lies in governance: cooperatives are governed by the principle “one member, one vote”; in privately owned institutions, registered perhaps as stock companies, voting power is by number of shares. Financial Service Associations in Benin, Guinea and Uganda permit unlimited ownership of shares, but restrict the number of voting shares.

Community Banks in Nigeria, based on a law enacted in 1990, are an example of a crossbreed between all three types, combining a variable mix of ownership by informal self-help groups, registered Community Development Associations and private individuals. Tossed around between deregulation and re-regulation, their number has widely fluctuated around 1000 (Marx 2005).

In post-conflict situations, informal finance as a cooperative coping mechanism has been found to develop much more quickly than semi-formal or formal microfinance, to do so at low cost, and to be more appropriate in terms of products and services. With increasing stability in the post-conflict environment, the following shifts have been observed: from loans in kind to loans in cash; from short-term to longer-term loans; from trust to trust-cum-collateral. Both consumption and production loans for low investments and quick returns are heavily in demand, in that order (Williams et al. 2001; Wilson 2002).

Reparation payments may be used for groups of recipients, together with people who bring in resources of their own, to first establish such IFIs according to local traditions, and then upgrade them. This may entail:

- enhancing management skills and operational practices;
- transforming rotating and nonrotating savings and credit associations, funeral societies and similar IFIs into permanent financial intermediaries;
- upgrading to semiformal financial institutions;
- mainstreaming and integrating into the formal financial sector.

Linkages between formal and informal finance

Linkages between formal and informal finance are another window of opportunities. Reparation payments can be instrumental in establishing self-help groups as informal financial institutions or in the upgrading of such groups to semi-formal and perhaps formal levels. Yet, without integration into national financial markets and access to capital markets at a later stage, there are

limits to their growth, which in turn imposes limits on the growth of the micro and small enterprises of the members of such institutions. Linkage banking has opened the way for virtually unlimited growth.

At their own initiative, and sometimes aided by NGOs, credit unions and donor agencies proposals, informal financial institutions have entered into numerous linkages, mostly depositing savings in cooperatives and banks. But being informal, these institutions had great difficulty in accessing credit from those banks or cooperatives. This is where APRACA, a Bangkok-based association of central and rural-agricultural banks in Asia and the Pacific, intervened. An increasing number of member institutions, such as Bank Indonesia, Landbank in the Philippines, NABARD in India, have encouraged banks to cooperate on commercial terms with financial self-help groups with joint liability. This has reduced the transaction costs of lenders and borrowers and simultaneously of deposit-takers and depositors. NGOs and other non-financial organizations have contributed social mobilization, training and consultancy services; some have also acted as financial intermediaries in the inception stage when banks lacked confidence in informal groups.

This has worked well in Asian countries where policy frameworks have favored financial innovations, cost-covering interest rates and institutional viability (Ghate 1992; Kropp et al. 1989; Seibel and Parhusip 1992; Seibel 1996). In Africa, where policy environments have been unfavorable or less stable, as in Nigeria, APRACA's sister organization AFRACA found it more difficult to promote linkage banking. However, some of its member institutions, such as CNCA in Burkina Faso, AFC in Zimbabwe, and the Central Bank of Nigeria, have taken promising initiatives. In Ghana, the World Bank, IFAD and the African Development Bank have been involved in a new initiative of linking indigenous savings and credit associations, the so-called susu clubs, and daily deposit collectors to banks.

Linkage banking, or SHG banking, as a strategy for linking banks with informal financial intermediaries and self-help groups (SHGs), is a three-pronged approach. First, local resources must be mobilized through member-owned local financial intermediaries and providing access to credit from commercial sources. Second, these SHGs/IFIs must be integrated into national financial markets. Third, banks must be enabled to reach out to smallholders and microentrepreneurs as a new market segment.

Indonesia is the country where linkage banking, under the auspices of the central bank and GTZ, was first implemented on a national scale, starting in 1988. Inspired by that experience,

NABARD, the National Bank for Agriculture and Rural Development in India, pilot-tested linkage banking during 1992-96 and achieved spectacular results within the last ten years. (Seibel 2005) With some modifications, the approach could also be jumpstarted by, or otherwise incorporate, reparation payments.

5. Conclusion

The goal of this article was to determine the possible role of MFIs and particularly MOIs in post-disaster and post-conflict reconstruction, with a special focus on the constructive use of reparation payments. Whereas emergency aid is primarily donor-driven, rehabilitation aims to establish a recipient-driven design of aid programs in line with local implementation capacity. Grants usually awarded for reconstruction in post-conflict areas or for reparations payments in post-disaster areas could be turned into equity and deposits. Equity and deposits will then enable to build institutions and create assets and ownership. Even if a grant component could remain during the relief stage to get the process going, the basic logic is the same for reconstruction support and for reparations payments.

Diversification of MFIs' activities and products should therefore be promoted. NGOs and MFIs may be instrumental in using reparation payments, together with other sources of finance, to promote the establishment, growth and development of sustainable local financial institutions (co-) owned by recipients of reparation payments. They may also improve the establishment, growth and development of sustainable farm and micro-enterprises owned by recipients of reparation payments. They can then offer a secure place for the safe-keeping and accumulation of reparation payments and savings. These two objectives are interrelated and mutually reinforcing. In post-conflict situations, they may provide the basis for a process of development from within, combining self-help and self-reliance with external financial and technical support.

Allocating reparation benefits to victims of civil rights abuses with a lasting effect on their well-being and self-help capacity is a tremendous challenge. In developing countries, MFIs could be instrumental in bringing about such a sustainable effect by accepting benefit payments as savings deposits and providing access to additional resources in the form of credit for investments in income-generating activities.

Bibliography

ARC – American Refugee Committee, International Sierra Leone Program (2002) *Finance Salone Business Plan 2002-2007*.

Addison T., A. Geda, P. Le Billon and M. Murshed (2005) Reconstructing and Reforming the Financial System in Conflict and ‘Post-Conflict’ Economies. *Journal of Development Studies*, 41(4): pp.703 – 718.

Ahmed, I. (2000) Remittances and Their Economic Impact in Post-Conflict Somaliland. *Disasters* 24(4): 380-389.

Consultative Group to Assist the Poor (2004), Supporting Microfinance in Conflict-Affected Areas, *Donor Brief* 21.

Consultative Group to Assist the Poor (2002) *Microfinance Policy Review Sierra Leone (Draft prepared by Mayada El-Zoghbi)* The World Bank, Washington DC.

De Greiff, P. (2003) *The Role of Reparations in Transitions to Democracy*. ICTJ, New York.

De Greiff, P. (2006) *The Handbook of Reparations*, Oxford University Press, New York

Ghate, P. (1992) *Informal Finance: Some Findings from Asia*. Asian Development Bank, Manila.

Glytos, P. (1993) Workers Remittances and Equality in Rural Egypt. *Economic Development and Cultural Change* 42(1): 131–68.

Gupta, S., B. Clements, R. Bhattacharya and S. Chakravarti (2002) The Elusive Peace Dividend. *Finance and Development* 39(4): 49–51.

Hammerich, U., M. Hamp, P. Hartig and R. Primahendra (2005) Designing a Microfinance Development Strategy as Part of Economic Recovery And Employment Promotion in Post-Tsunami Aceh. *Joint GTZ-KfW Fact-Finding Mission*.

Hudon, M. (2004) New Challenges in Microfinance: The Case for Extending its Range of Financial Services. *Belgian Banking Review* 6: 333-338.

Hudon, M., Lietaer, B., (*forthcoming*), “Natural Savings: A New Microsavings Product for Inflationary Environments”, *Savings and Development*.

International Fund for Agricultural Development - IFAD (2001) *Rural Finance for the Poor: From Unsustainable Projects to Sustainable Institutions*. IFAD, Rome.

ILO (2005) Indonesia: Notes on Reconstruction. The December 26, 2004 Natural Disaster. *ILO Working Paper*.

International Monetary Fund (2000) Liberia: Selected Issues and Statistical Appendix. IMF Staff Country Report No.00/50, Washington, DC: International Monetary Fund.

Johnston, B. R. (2000) Reparations and the Right to Remedy. World Commission on Dams Contributing Report, Thematic Review 1.3: Displacement, Resettlement, Reparations, and Development.

Kooi, P., Tucker, J. (2003) Microfinance Sector Development in Sierra Leone – An Assessment. UNCDF Working Paper.

Kropp, E., M. T. Marx, B. Pramod, B. R. Quiñones and H. D. Seibel (1989) *Linking Self-help Groups and Banks in Developing Countries*. APRACA, Bangkok, and GTZ, Eschborn

Marx, M. T., Assessment of Community Banks in Nigeria. WP 2005-5, in www.uni-koeln.de/ew-fak/aef/

Matin, N. and M. Taher (2001) The changing emphasis of disaster in Bangladesh NGOs. *Disasters* 25(3): 227-239.

McKinnon, R. I. (1973) *Money and Capital in Economic Development*. The Brookings Institution, Washington DC.

McVay, M. (2005) BDS in Conflict Environments Neglected Potential? *SEEP Online Discussion Synthesis*.

OECD (2005) African Economic Outlook 2004/2005: Democratic Republic of Congo, OECD: Paris.

Ohanyan, A. (2002) Post–Conflict Global Governance: The Case of Microfinance Enterprise Networks in Bosnia and Herzegovina. *International Studies Perspectives* 3(4): 396-416.

Quiñones, B. R. and H. D. Seibel (2000) Social capital in microfinance. Case studies in the Philippines. *Policy Sciences* 33 (3&4): 421-433.

Seibel, H. D. (1996) *Financial Systems Development and Microfinance*. Rossdorf: TZ-Verlag; GTZ, Eschborn.

-. (2001) Rural Finance: Mainstreaming Informal Financial Institutions. *Journal of Developmental Entrepreneurship* 6(1): 83-95.

-. (2003) History Matters in Microfinance. *Journal of Small Enterprise Development* 14(2): 10-12.

-. (2005). The Evolution of SHG Banking in India. WP 2005-9, in www.uni-koeln.de/ew-fak/aef/

-, with Andrea Armstrong (2006) Reparations and Microfinance Schemes. In: Pablo De Greiff, ed., *The Handbook of Reparations*. New York: OUP: 676-698

- and U. Parhusip (1992) Linking Formal and Informal Finance: An Indonesian Example. In Adams, D. W., and D. A. Fitchett, eds. *Informal Finance in Low-Income Countries*. Boulder CO: Westview Press, 239-248; reprinted in: M. Harper, ed., *Microfinance*. London: ITDG Publishing, 2003: 11-24

UNDP and World Bank (2000) Colloquium on Microfinance: Disaster Risk Reduction for the Poor. Proceedings, New-York.

http://www.proventionconsortium.org/files/microfin_020200/proceedings.pdf

Williams, A., U. Vantha and S. V. Ngim (2001) Post conflict microfinance in Cambodia. The Springfield Centre for Business Development, Durham.

<http://www.PostConflictMicrofinance.org>

Wilson, T. (2002) Microfinance during and after Armed Conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda. The Springfield Centre for Business Development, Durham.

<http://www.PostConflictMicrofinance.org>

Winchester (2000) Cyclone Mitigation, Resource Allocation and Post-disaster Reconstruction in South India: Lessons from Two Decades of Research. *Disasters* 24(1): 18-37.