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Beyond Economic Benefits: The contribution of microfinance to post-conflict recovery in Asia and the Pacific.

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Abstract

Microfinance in a post-conflict context is often described as a powerful tool to boost local economic development and to support post-conflict rehabilitation assistance. However, little research has been undertaken to look beyond microfinance's economic benefits, at social mobilization, empowerment, stabilisation, peace-building and solidarity, through social capital enhancement. This paper describes microfinance's intangible benefits, by reviewing the literature and exploring and synthesising lessons from conflicts in nine countries in Asia and the Pacific, with emphasis on microfinance experiments in Afghanistan, Papua New Guinea (Bougainville), Sri Lanka and Timor Leste. This paper demonstrates that microfinance promotes conflict resolution, for example by empowering members to establish their own organisation. It encourages democratic procedures that help people surmount conflicts, while providing a way to bring people together, focusing on economic activities and cooperation rather than differences. Microfinance provided to different ethnic groups can also contribute to social and political reconciliation, as it provides a forum for a unified voice for peace, with people cooperating and working towards a shared future. Moreover, microfinance also encourages reintegration of refugees and demobilised soldiers by providing finance to mixed groups linked by joint liability. Finally, microfinance is also a tool to empower people by regaining trust and confidence in each other.

Introduction

Armed conflicts have devastating consequences on development, not only in terms of depleting economic and organisational capital, but also in decreasing social capital through loss of trust, diminished interaction and increased tensions between ethnic groups, and in declining human capital through death and displacement, loss of self-esteem, and trauma.

It is widely accepted that microfinance operates under similar principles in both stable and conflict-affected contexts. As described by Doyle (1998), microfinance in a post-conflict context can be a multi-use tool. First, it can restart and boost local economic development by providing access to financial services. Second, it can be a component of the immediate post-conflict rehabilitation assistance. These well-known principles and beneficial consequences need not be explored at length here. Rather, this paper describes the intangible benefits of microfinance, and synthesises lessons from microfinance experiments in conflicted parts of Asia and the Pacific.

In fact, little research has been undertaken to look beyond microfinance's economic benefits, at social mobilization, empowerment, stabilisation, peace-building and solidarity, through social capital enhancement. First, the literature review will demonstrate that microfinance's intangible benefits have been only partially described in the research on microfinance as a tool for peace-building and reconciliation. Second, these benefits will be explored through cases studies from Asia and the Pacific, with detailed reviews of Afghanistan, Papua New Guinea (Bougainville), Sri Lanka and Timor Leste. These country studies also exemplify the difficulties in implementing microfinance programs. Finally, the conclusion will draw lessons from the country studies in the light of the intangible benefits initially described.

1. Literature review

Violent conflicts mostly affect the poor, as they are physically vulnerable, living in hazardous conditions, without strong social safety nets. Conflict results in a constant feeling of insecurity that erodes the social capital of the poor, weakens their organizations, constrains social and physical mobility, and prolongs poverty's vicious circle.

Reconciliation and conflict resolution

Microfinance encourages reconciliation and conflict resolution (Doyle, 1998) by involving cross-ethnic cooperation; for example producers and consumers interact across ethnic borders. Research in Cameroon (Heen, 2004) has demonstrated that greater availability and access to credit could help resolve conflict tensions at three different levels:

- Direct mitigation: credit provision supports economic projects that could directly alleviate conflict pressure.
- Indirect mitigation: by contributing to poverty alleviation, microfinance has positive benefits in communities where conflict is fuelled by persistent lack of revenue.
- Process mitigation: by creating contact between hostile groups through credit methodologies, microfinance helps reduce mutual prejudice.

Larson (2001) mentions that 'intangible benefits of microfinance' have a significant role in social and political reconciliation, for example by supporting interethnic economic activities and trust built through multi-ethnic banks and solidarity group lending. Essentially, interethnic business relationships nurture peace and reconciliation in a community.

Resumption of a 'normal' life

According to Larson (2001), microfinance by definition needs to operate on a relative large scale and over the long term to be viable, conditions that also bring stability in communities highly dependent on otherwise temporary aid, and thus smooth the transition to 'normal life' after conflict. Credit is therefore an alternative to over-reliance on humanitarian aid, and mitigates the emergency mentality, providing a psychological and economic incentive to look at sustainable development.

In fact, microfinance could also be used to ease post-traumatic stress, as credit officers become agents of trauma healing through their interaction with loan recipients. Borrowers or savers are able to talk business and future prospects, which helps trauma and war memories to fade. 'Credit plus' approaches in conflict-affected environments include non-financial services, such as health education, literacy, human rights and reconciliation awareness, as well as psychological counselling.

Enhancing social capital

Microfinance is reported to develop social capital through solidarity mechanisms. Low social capital is a major impediment to successful microfinance (Berold, 2002), but community banks can be used to rebuild trust and cooperation among people affected by the conflict. However developing solidarity mechanisms around reconciliation goals can be difficult and even dangerous. The process of reconciliation should have already been initiated before attempting to work with belligerent ethnic groups through microfinance. In fact, it is never recommended to force interethnic partnership, through microfinance or any other means. Rather, regular interaction over time will allow people to regain trust progressively, for example, through multi-ethnic community banks comprised of mono-ethnic solidarity groups.

Reintegration of refugees and demobilized soldiers

Microfinance can encourage the reintegration of refugees, returnees and demobilized soldiers, by facilitating the development of economic activities, collaboration with local populations and fulfilment of entrepreneurial spirit (Larson, 2001). When people need to earn a living to survive, 'business is business', and conflict becomes secondary.

Microfinance supports refugee return by providing access to finance for business development and house reconstruction. It can also be the financial component of reintegration packages provided to ex-combatants in demobilisation programs. 'A lack of employment and income-generating opportunities for ex-combatants increases risks of economic migration into activities that may include crime, arms and goods.' (OECD, 2001). Moreover, 'economic opportunities provide people with a stake in peacemaking, and incentive for combatants to lay down their arms and for the community to encourage them to do so.' (Berold, 2002)

2. Country-based experiences

2.1 Afghanistan

The context
After the fall of the Taliban regime in November 2001, a major impediment to economic opportunity for many Afghans was the weakness of the formal and informal financial sector. Another important issue was the chronic indebtedness of rural population, victims of exploitative forms of credit provision.

An additional problem was the increasing reliance on the opium economy and the lack of alternative income sources, resulting in indebtedness of local communities dependent on opium traders' financing. For a majority of poor farmers, opium cultivation is a way to access credit and inputs, although on exploitative terms (Pain, 2002).

The financial sector
At the end of 2001, Afghanistan's formal financial system was virtually non-operational, with insolvent public financial institutions, and no private banks. Hence, dependency on informal sources of finance (such as family and friends, moneylenders and shopkeepers, traders, and landlords) increased. Microfinance programs had limited outreach (approximately 10,000 clients at the end of 2001) and weak institutional structures. Savings services were limited to a few informal schemes and in-kind saving such as opium in poppy-growing areas. (CGAP, 2002).

Funds transit through a system of informal money transfers and exchange, called Hawala, based on informal connections between dealers ('Hawaladars'). With transfer movements balancing over time, no actual transfer of cash is needed, except in rare cases where balances are paid in kind or in cash, or where large sums require the use of the formal financial system. Commonly used in many Muslim countries for almost a century, this system is a reliable, convenient and inexpensive way of transferring funds into and within Afghanistan. Recently, it has been used by international relief agencies to transfer funds, but has also been suspected in illegal activities. In addition, Hawaladars provide a wide range of financial and non-financial services such as trade finance, deposit taking and microfinance. Found in almost every community, Hawaladars provide microentrepreneurs with deposit taking facilities as well as credit (Maimbo, 2003).

Microfinance development
The extensive war damage to physical and human capital, the pre-war poverty, the highly criminalized war economy, and the very low population density are all substantial constrains to the development of microfinance. However, microfinance can also benefit from the extraordinary resilience of Afghans and their developed sense of entrepreneurship (CGAP, 2002). During the conflict and the Taliban regime, only a few NGOs, such as Save the Children in northern Afghanistan, were providing microfinance services. Other NGOs and UN agencies operated mostly microcredit schemes using Islamic finance principles as part of integrated development programs. These achieved limited outreach (12,000 clients as of October 2002), and low sustainability due to a handout approach, hyperinflation and interest rate caps imposed for religious reasons (CGAP, 2002).

At the end of the conflict, microfinance was needed to fill the enormous gap left by formal finance, and to support the growing informal sector. With a population over 20 million, the demand for microfinance services was estimated to be at least 1 million households (Pearce, 2003).

<u>Support to microfinance</u>
Started in June 2003, the Microfinance Investment and Support Facility for Afghanistan (MISFA) is a multi-donor mechanism that provides qualified local microfinance institutions (MFI) with grants and loans for lending capital and institutional capacity building. The limited number of competent MFIs was initially identified as a key constraint in the disbursement of funds, however MISFA is now funding a number of microfinance providers, mostly in the northeast, and in Kabul and nearby districts. As of June 2004, MISFA partners collectively reached 35,000 clients, including 92% women, posting a 99% repayment rate.

Started in 2003, the ILO Afghanistan Microfinance for Employment Programme aims at improving the capacity of new entrants to the microfinance sector. The program strengthens the NGO partners so they can have access to funding and other forms of support through the MISFA program.

Microfinance providers

Regulated microfinance institution

In September 2003, the central bank awarded an operating license to **First Microfinance Bank of Afghanistan (FMFB)**, the first foreign-owned bank to operate in Afghanistan, with financial support from the Aga Khan Fund for Economic Development (AKFED) and from other investors such as IFC and KfW. FMFB focuses on microenterprises and small businesses, and intends to provide a full range of credit and savings products, as well as transfer services.

Development programs and NGOs

The **Aga Khan Development Network (AKDN)** operates the Afghanistan Rural Microcredit Programme (ARMP) in five provinces, with average loan sizes from US$25 (village banking) to US$500 (individual credit). It also provides group solidarity credit and 'special loans' designed to support families where a family member is poppy-addicted. At the end of 2004, ARMP served 3,300 borrowers, 95% through individual lending. (Sirolla, 2005).

BRAC Bangladesh started microfinance activities in Afghanistan in July 2002, offering credit and savings services to women groups of thirty to thirty-five members (Karim, 2003). BRAC reached 10,000 clients in twelve provinces at the end of 2004, with no defaults.

At the end of 2004, **FINCA Afghanistan** operated a village banking program serving over 3,500 clients in Herat province (Bedford, 2005). Working mostly with women's groups, FINCA employs female credit officers to reduce tension when meeting clients. (Washington Times, 2004).

CARE Afghanistan assists widowed heads of households with range of services from food distribution to health and education. Its microfinance program, the MicroFinance Agency for Development (MoFAD), uses a savings-based methodology to reach 1,000 poor women, in more than fifty savings and credit groups in Kabul (CARE, 2005).

Save the Children (US) has been implementing a Group Guaranteed Lending and Savings (GGLS) scheme since 1995, with strong emphasis on efficiency and sustainability, and builds on the strengths of village solidarity and traditional banking services. In 2002, it had 1,900 active clients.

The **Agency for Rehabilitation and Energy Conservation in Afghanistan (AREA)** is the only Afghan NGO funded by MISFA. AREA manages development projects with microfinance components supporting community-based savings and credit activities and group lending. It also extends larger loans to micro and small enterprises (Pearce, 2003).

Parwaz is an Afghan MFI established in 2002 entirely managed by Afghans, using a streamline methodology based on ASA Bangladesh and Save the Children Afghanistan. It uses a group methodology to provide credit, savings, and insurance services and received the Pro-Poor Innovation challenge from CGAP and IFAD in 2004.

Starting in July 2004, **Women for Women International** is one of the few MFIs working exclusively with women in Afghanistan, using a Grameen Bank model, and funding from Grameen Foundation USA and MISFA (WFWI, 2004).

Mercy Corps International has established a separate microfinance institution, Ariana Financial Services Group (AFSG), to provide high-quality savings and credit products. AFSG expects to reach over 5,000 clients and had over $600,000 in loans outstanding by the end of 2004 (MCI, 2004).

Other major microfinance providers are **WOCCU**, building three pilot credit unions over 2004-05, and contributing to the development of new credit union legislation (WOCCU, 2004). **Child Fund Afghanistan** (CFA) managed by Christian Children's Fund, is an implementing partner of the UNDP-Afghanistan New Beginnings Programme (ANBP), which includes microcredit schemes to ex-combatants through reintegration packages. At the end of 2004, CFA had 1,800 active clients. (Amer, 2005). **CHF International's** Afghanistan Microfinance Initiative (AMI) offers two group-lending products to rural households and shopkeepers in two provinces. **International Assistance Mission (IAM)** is a faith-based Swiss NGO active in Afghanistan for the last 35 years. It recently started a microfinance program, which at the end of 2004 served more than 600 clients, achieving a 100% repayment rate. (Obenschain, 2005)

Effects of conflict on microfinance
Because many people lost their savings in bank collapses during the conflict, new microfinance providers encountered high levels of mistrust of financial services. The conflict eroded social capital, as communities were dispersed and institutions destroyed, requiring MFIs to invest in confidence building (Sirolla, 2005).

The initial challenge was also to introduce microfinance as a totally new concept, convincing people to repay loans in a culture of handouts. (Fakiri, 2003)

The general climate of insecurity involved additional costs and lower sustainability levels, causing MFIs to restrain their expansion in rural areas, preferring relatively safer urban settings (Bedford, 2005).

Due to the restrictions imposed during the Taliban regime and the extreme fragility of the education system, most MFIs had to heavily invest in human resources development. They hired expatriate staff and some skilled Afghan refugees in neighbouring countries to fill key management positions, while heavily investing in training for local staff.

Impact of microfinance on conflict mitigation
The provision of microfinance to different ethnic groups is a way to contribute to the social and political reconciliation of Afghanistan (Sirolla, 2005). It provides people with new alternatives to the conflict and illegal activities. Microfinance groups have been a voice for disseminating the positive effects of peace (Bedford, 2005)

CFA uses mixed groups of ex-combatant and local farmers, linked by joint repayment liability. With the first loans benefiting ex-combatants, the rest of the members are encouraged to collaborate with them to ensure prompt repayment so they can have access to loans once ex-combatants have repaid the first cycle of loans. Over time, group members lose any sign of differentiation, meeting regularly for microfinance purposes, but also to discuss problems and find solutions together. This reinforces solidarity and collaboration. Savings accumulation reinforces feelings of solidarity and achievement, and encourages shared responsibility, trust, and cooperation. (Amer, 2005)

2.2 Cambodia

From the early 1970s to mid 1990s, the conflict in Cambodia resulted in millions of deaths under different oppressive regimes, especially the Khmer Rouge. It was only after the 1991 peace accords that the conflict ended, though some rebel activity continued until the mid 1990s.

Most forms of social capital in Cambodia were destroyed after thirty years of warfare. Villages were forced to relocate or were split. Community and family members were encouraged to spy and report on each other, which destroyed trust (Collier et al. 2003). It has been difficult to expand village banks, as trust and confidence, the building blocks of group-based methodologies, took time to be restored (Nagarajan, ILO 1999)

Some local forms of credit unions in Cambodia don’t use the terms “cooperative” and “credit union” translated into Khmer, as they are associated with the terror and forced collectivisation under the Khmer Rouge. For example, CCSF, a credit union federation, uses the terms “savings banks” to describe its local partners.

2.3 India

Peace-building is one of the socio-economic activities undertaken by self-help groups (SHG) in India (Wilson, 2002), in addition to microfinance, education, disaster preparedness, and income generation. With the financial resources acquired through microfinance activities, SHGs can be catalysts for information and change, and vehicles to bring peace to their communities. ‘Interfaith, interethnic, intercaste tolerance and conflict resolution’ describe their peace-building activities. However, it is difficult to isolate the impact of microfinance activities on peace-building.

2.4 Indonesia

In the province of the Maluku, the 1999-2000 conflict between Muslim and Christian communities resulted in more than 5,000 deaths and generated massive displacement (up to a quarter of the population). The conflict created deep communal divisions fuelled by religious antagonism between local militia groups. The local economy was affected as the market for goods and services divided along religious lines, which also restricted freedom of movement of clients. Large businesses shut down and informal sector enterprises flourished, while bank and government offices scaled down.

During the conflict, most formal and semi-formal sources of finance evaporated, while moneylenders expanded their exploitative practices. MFIs worked exclusively with one religious group (clients and staff) while new microfinance providers emerged (such as Mercy Corps) to provide more affordable sources of finance (Gaucher). By the end of the conflict, MFIs worked with a more mix client base. A survey found that Internally Displaced Persons (IDPs) were more likely to have higher income than local residents. One mechanism for coping with displacement was to become a microentrepreneur, and they were also able to save on housing and utilities, living in camps or with friends or family.

Conflict mitigation
During the conflict, one of the rare opportunities for interaction between Christians and Muslims was a neutral marketplace, located at the border between the two communities. By receiving access to microfinance, local traders interacted and utilised the interdependence of the two communities despite their religious divisions. In one case, two fishing groups belonging to the same community, but in conflict, started to work together after receiving microfinance. Market forces, liberated by the access to microfinance, proved to be stronger than internal divisions.

2.5 Nepal

Since early 1996, the war between Maoist insurgents and the royalist government forces has spread throughout the country, causing more than 10,000 deaths. The roots of the conflict lie with the inequitable socio-economic and political access of the poorer classes of society, bad governance, corruption and higher poverty indicators in rural areas. The conflict has had major negative impacts on the economy and the life of the poor. Approximately 30% of the public bank branches have been attacked by Maoist rebels, resulting in widespread closure of rural branches.

Microfinance has also been targeted, but to a lesser degree. According to Shrestha (2005), MFIs have had their staff threatened, and some offices looted and burned. Maoist rebels also put pressure on microfinance providers to lower their interest rates (Sharma, 2003). With the closure of commercial banks in rural areas, MFIs have found it very difficult and costly to transport cash in the countryside, resulting in fewer microcredit disbursements and increased delinquency. Nirdhan Utthan Bank, a leading MFI, report that insurgents have harassed staff, looted money and forced clients not to repay their loans. One of the recommendations of RMDC, an apex organisation (Shrestha, 2005), was for MFIs to conduct public information sessions with local community leaders and clients, to convince them that microfinance is a development tool to assist the poor and that interest rates are much lower than what local communities usually experienced with moneylenders.

Most of the grassroots Saving and Credit Cooperatives (SACCOS) remain unaffected (Sharma, 2003), with the exception of Small Farmer Cooperatives Ltd. (SFCLs), perceived as a government program (as they are linked to the Agriculture Development Bank of Nepal). In fact, the RUFIN program (Wehnert & Shakya, 2003) reported an increased number of attacks against SFCLs over time. At the end of 2002, almost 30% of SFCLs had been attacked, with documents burned and land certificates of members stolen. The insurgents' objective in destroying loan records and stealing collateral, is to gain sympathy from borrowers who then wouldn't have to repay loans. Consequently, delinquency levels increased among SFCLs, while financial viability decreased, as they were forced to lower loan interest rates but to maintain savings interest rates. Despite the attacks, a vast majority of SFCLs were able to quickly restart their operations, thanks to the collaboration of members who volunteered to re-establish records.

In response to the threats of violence, SFCLs also adopted a series of coping mechanisms (Wehnert & Shakya, 2003):

- Signboards explaining the purpose, self-reliance objective, and autonomous status of SFCLs, complemented by a national press conference.
- SFCLs implemented security and cash management procedures, such as securing copies of important documents in a separate location, and a policy of not keeping cash in the office after hours.

SFCL groups are perceived as useful forums for conflict mitigation within communities, as members meet regularly to carry out economic and financial activities (Shrestha, 2004).

2.6 Papua New Guinea (Bougainville)

The context

Bougainville is part of the North Solomon Islands province of Papua New Guinea (PNG), and is culturally and geographically close to the Solomon Islands. Violence erupted in 1988 over land compensation from a mining company, and degenerated into a rebellion against the central government and a claim for independence. The internal conflict lasted until 1998, claiming the lives of almost 12,000 people in a population of 180,000. The 2001 peace accord provided greater autonomy for Bougainville, local elections, and the promise of a future referendum on independence.

Economic activity and trade virtually came to a halt during the conflict, while most of the physical infrastructure was destroyed. Only one sub-branch of a commercial bank continued to operate in Buka, the main town. The local population was severely affected by schools closing, decreased incomes and heavy reliance on subsistence agriculture (Newsom, 2003-2004).

The Bougainville Microfinance Scheme

The main objective of the project was to help people accumulate capital to rebuild their lives through a self-reliant, savings-first methodology. The project was initiated by the local government and PNG central bank through a series of design workshops held between 1996 and 1998. Workshops identified the need to reinvigorate a spirit of self-reliance and to enhance a feeling of unity and common purpose among Bougainvilleans. Operations began in 1999, managed by Australian Volunteers International (AVI) in partnership with the Credit Union Foundation Australia (CUFA) and with AusAID funding.

The microfinance scheme uses a three-tier structure, with savings and credit groups at the first level (grassroots), financial intermediaries at the second level (district) and an apex body, Bougainville Haus Moni (BHM) at the third level (region). BHM supports the institutional development of the two first tiers, while acting as central financial intermediary (Newsom, 2002).

As of June 2003, there were 270 grassroots savings and credit groups and 17,476 members, with A$390,000 in savings and A$215,000 in outstanding credit (Newsom, 2003-2004). In November 2004, the project, renamed "Bougainville Microfinance Association" had 22,000 members in 380 groups as it entered into a new phase of development, with its eventual transformation into a "Peoples' Microfinance bank", adopting a more formalised structure and commercial approach, ensuring sustainability with a five to six year horizon.

Effects of conflict on microfinance

Initially, the project had to broaden its microfinance scope to include training in literacy, numeracy, community development, vocational and management skills, as these were all lacking. Later on, new projects and organisations took over these tasks (Newsom, 2002).

The lack of trust among people and diminished social capital at all levels have been major constraints in the development of the microfinance project. The crisis had exacerbated the pre-existing mistrust among people, making people adverse to forming grassroots groups and to joining a financial intermediation scheme with others (Newsom, 2003-2004).

On the positive side, moving large sums of money between grassroots groups was never a security issue, and no incidents were reported.

Impact of microfinance on conflict mitigation

While the internal conflict was still active, people from opposing sides participated in design workshops, inspired by a desire to build cooperation and a social structure with which all Bougainvilleans could identify themselves equally. Even if peace and reconciliation were not the agenda of planning workshops, they were a result, as everybody was working towards a shared future. The workshops were seen as havens, where trust began to be rebuilt, and peace and reconciliation were again possible (Newsom, 2003-2004).

2.7 Philippines

In 2000, fighting broke out in Mindanao between the Moro Islamic Liberation Front (MILF) and the Philippine Armed Forces, displacing hundreds of families and causing some casualties. Loan repayments were made difficult due to decreased economic activity and diversion of available funds to consumption and medical purposes. SFI, a CRS partner microfinance institution, granted its clients a grace period to repay loans. SFI also allowed loan rescheduling on a case-by-case basis when businesses were severely affected by the conflict, or when sickness or death occurred in the family. Meanwhile clients were encouraged to continue repayments, even very small ones. These measures limited loan defaults and losses (Seller, 2003).

A different study (Rivera, 2003) found that other MFIs declared a moratorium on loan repayments and didn't impose late payment penalties. This impacted their performance and sustainability negatively, because default and late repayments increased to alarming levels. Nevertheless, the study also found that MFI clients affected by the conflict were more resilient than others, as they had accumulated larger assets, and diversified their sources of income.

2.8 Sri Lanka

The context

The social and economic exclusion of the indigenous Tamil group, and the failure to address their political alienation resulted in a call for a separate Tamil state in the 1970s. The situation deteriorated into armed conflict in the 1980s, between the army and the main rebel movement, the Liberation Tigers of Tamil Eelam (LTTE). The 2001 ceasefire allowed reconstruction to begin in 2002.

Approximately 2.5 million people (World Bank) lived in areas directly affected by the two-decade long conflict, resulting in loss of life (65,000 killed), population displacement (800,000 internally displaced, and 700,000 left the country), and the severe destruction of infrastructure in the northern and eastern regions.

Microfinance development in conflict-affected regions

The northern and eastern regions have been excluded from major government-led microfinance initiatives during the conflict. Jaffna, in the north, had the best cooperatives in Sri Lanka before the conflict, as well as a strong banking system. Although continued access to finance was provided by local cooperatives, many branches closed down. Commercial banks provided saving facilities, but credit access remained difficult, and was almost entirely provided by international donors and relief and development agencies. In 2002, a study (Gant and al.) showed that Jaffna had the lowest access to microfinance services in Sri Lanka, partly due to a lack of institutional capacity and efficiency of microfinance providers. In 2004, reports showed that populations in the north and east still lacked financial services, despite the success of the Samurdhi programme in savings mobilisation. The population's displacement and dependency on subsidies, as well as lack of skills among clients and staff, were major constraints to microfinance development.

A distinct characteristic of the conflict environment was that most microfinance clients were relatively well-off before the conflict but fell into poverty as a result of the war. When they returned to their homeland, they only needed a kick-start to resume productive economic activities, in sharp contrast with the slower graduation of 'chronic' poor elsewhere.

UNHCR used a Grameen model in the conflict area, to develop the capacity of displaced people to establish a basic level of security, and to link them to other agencies that would take them to a higher level of development. Groups of five to thirty members met regularly, mobilising savings and taking small loans.

The Capacity Building of Community Based Organizations (CBOs) in Jaffna project (CAB-J) was implemented by CARE between 2000 and 2002, with financial support from DFID. It aimed at reducing the vulnerability of poor households by strengthening twenty CBOs to enable them to provide sustainable financial services to 1,700 beneficiaries. CAB-J partners received extensive training in microfinance and institutional development, and successive grants to finance revolving loan funds used to on-lend to members. The project adopted a business-like approach to microfinance, using international best practices, and giving each CBO full responsibility in fixing loan and savings terms and conditions. It also operated in some communities divided by the conflict or the caste system. Credit and savings associations were a way to bring people together, focusing on economic activities and cooperation, rather than on differences (CARE Sri Lanka, 2002-2003).

The goal of another program, run by the Danish Refugee Council (DRC), was to secure durable solutions to problems faced by IDPs, through support for livelihoods and local capacity building. DRC's integrated programme (social, economic and infrastructure interventions) included Revolving Loan Funds (RLF) managed by local communities organised in CBOs that disbursed credit to their members. DRC's local NGO partners, were given the overall responsibility of facilitating and monitoring the process, using microfinance best practices. The program resulted in improved savings habits, high loan repayment and local capacity development. Social mobilization was a key to the success of RLFs, avoiding a too narrow focus on economic development. (Lauritzen, 2003).

Impact of the conflict on microfinance provision

Years of conflict destroyed formerly successful structures and systems of savings and credit in the north and east. In conflict-affected areas, relief-focused donors set a bad example in providing credit with low interest and lax repayment monitoring, establishing further dependency on subsidised credit and the impression of a quasi-grant delivery. Subsequently, local authorities demanded that low-interest loans be provided by new microfinance operators. At the beginning of its microfinance operations, DRC found that clients were dependent on grants and relief activities, and were not confident in starting savings or borrowing for profitable economic activities. Market opportunities were also scarce in the wake of the conflict (Achyut, 2002-2003).

In CARE's experience, some credit and savings groups failed either because their members belonged to different militia groups, or because the conflict was an excuse to stop repaying loans. According to CARE, clients approached economic activities with a very short-term horizon. They didn't want to invest or commit to long-term objectives in an uncertain future, as the ongoing conflict had eroded faith in a return to normality. In the DRC program, the same feeling of instability among resettled IDPs emerged, as they still feared further displacement, and were reluctant to make the long-term commitments required by microfinance.

In both the CARE and DRC experiences, a loss of social capital meant that people had difficulty taking ownership of their own microfinance structure. Moreover, in resettled villages, people had difficulty rebuilding economic capital and accessing regular finance, as property rights were lost during the conflict.

Impact of microfinance on conflict mitigation

A national survey (Gant et al., 2002) reported that microfinance is an effective tool in the recovery of local economies. It can foster local economic growth by giving local entrepreneurs access to financial services, shifting the focus from grant relief to long-term development.

According to Sheehan (2003), microfinance is vital in promoting peace by supporting economic recovery and boosting income in conflict-affected populations. Access to finance for reconstruction has positive influences on rebuilding assets, but also on developing trade, which in turn improves reconciliation. Consumers re-establish relationships with vendors and benefit from interacting. Finally, access to credit can ease the war trauma by providing a return to some kind of normality, and providing hope of a better future.

Bigdon and Korf (undated) report that microfinance can also foster empowerment of local communities. The creation of savings and credit groups is the first step in reactivating long-term development, as the groups then transform into more formal structures, such as CBOs, thus strengthening the conflict-affected communities' resilience and collective action. By working together to build their own organisations, people surmount their internal conflicts. However, it can also have negative effects (Bigdon and Korf, undated), with cases of revolving funds built up by savings groups hijacked by LTTE to fund development projects that were not initially earmarked by group members.

In the CARE experience, having community meetings in individual houses was a way to boost the host family's self-esteem, and to develop social relationships and ownership of the microfinance scheme. (CARE Sri Lanka, 2002-2003)

The DRC experience showed positive effects of microfinance on the conflict (Lauritzen, 2003). First, by combining social and economic support, it contributed to changing people's attitudes towards each other, and created a base for reconciliation and coexistence. Microfinance was a key instrument to turn an atmosphere of violence into progressive development and peaceful cohabitation. Second, by undertaking activities that encourage trust, goodwill and cooperation between people, microfinance contributed to re-establishing the social capital of conflict-affected communities. The credit methodology used small groups mixing host and relocated families, which turned to be the ideal vehicles for sharing experiences, discussing problems and solving conflicts. The requirement of savings mobilisation through a community-based approach also generated trust and cooperation between people, and a feeling of belonging and solidarity among community members. People had to entrust community members with their own money and follow internal rules, and therefore built social capital. (Achyut, 2002-2003)

2.9 Timor Leste

The context

Following the 1999 referendum on independence, 90% of East Timor's public infrastructure was destroyed by Indonesian troops and pro-autonomy militias, while as much as a third of the population was displaced to West Timor, in Indonesia. From 1999 to 2002, East Timor, under the administration of the United Nations, received substantial funds and support for reconstruction and peacekeeping. Officially known as Timor Leste, it became the newest independent nation in 2002, following centuries of Portuguese colonial rule, and twenty-four years of Indonesian occupation. It also became one of the poorest Asian countries, with a GDP per capita estimated at about US$495 in 2002, and 41% of the population living below the national poverty line of $0.55 per capita per day.

The development of microfinance is constrained by low population density and the small size of the microfinance market, 60,000 households (Hansen & Novanto, 2005). Moreover, the difficult geographical terrain makes the provision of financial services even more difficult and costly, while few people have experience working with rural credit and savings organisations. Another constraint is the low level of economic activity in rural areas dominated by semi-subsistence agriculture, and an overwhelmingly reliance on petty trading of a narrow range of goods (Todd, 2004-2005).

The financial sector

In addition to the banking operations of three commercial banks, a non-bank financial institution (Instituição de Microfinanças de Timor Leste, IMTL), a small credit union movement, and a number of NGOs are involved in microfinance. Commercial banking is still restricted to Dili and to a limited number of organisations and companies, and does not serve low-income populations. Some development projects, notably funded by the World Bank, have included subsidised credit components in recent years. The credit component of the Community Empowerment and Local Governance Project (CEP) provided small loans to groups of rural borrowers, while the Small Enterprise Project (SEP) offered a wider range of individual business loans, disbursed in or near district-level towns. The two projects experienced poor repayment (approximately 40% for CEP, and 60% for SEP) due to weak lending practices (Conroy, 2004).

Microfinance development

The main providers of microfinance are the regulated IMTL, three specialized NGOs and a number of microfinance programs. Microfinance outreach is higher in Dili, Bobonaro and Cova Lima districts with market penetration rates (clients/total households) above 20%. NGOs focus mainly on microcredit, using group lending methodologies, with some adapting the Grameen Bank model, and others developing self-help groups. Some NGOs require compulsory savings, while self-help groups mobilize their members' savings. IMTL provides a wider range of services, with individual and group credit products, and savings deposits services.

Credit unions provide individual loans to members while accepting savings deposits. Their outreach is limited to Dili and to areas where coffee cooperatives operate. USAID supports the development of coffee cooperatives, including a training centre and microfinance initiatives. An attempt to rehabilitate the Credit Union Federation (CUF) was initiated by Asian Development Bank (ADB), but failed due to poor management practices within the credit union movement and a lack of transparency. At the end of 2004, CUF reported forty-four cooperatives with 2,000 members, only three of which had more than 250 members.

Regulated microfinance institution

Operating under a limited banking license, ITML was initiated and developed by the ADB, with funding from the Trust Fund for East Timor. The licence allows IMTL to accept deposits, to extend credit (65% microcredit), to provide transfer services and to offer current accounts. Started in mid-2002, ITML uses the successful model of the CARD Bank in the Philippines, and operates through branches in Dili and two district capitals. At the end of 2004, it reached 8,000 savers and 3,000 borrowers, providing larger loans than other microfinance providers (Hansen & Novanto, 2005). Considered the largest deposit-taking institution, ITML is restricted by licensing requirements from growing its deposit fund beyond the current US$1 million, and intends to obtain a full banking licence in the future. Despite a relatively high repayment rate, ITML faces delinquency problems, and hasn't yet reached self-sufficiency (ADB, 2001-2004).

NGOs specialised in microfinance

The main local organisations specialized in microfinance are Oportunidade Timor Lorosae, Moris Rasik and Tuba Rai Metin (Hansen & Novanto, 2005).

Oportunidade Timor Lorosae (OTL) is supported by Opportunity International, and in April 2000, began providing small, short-term individual loans with daily repayments. This enabled the organisation to maintain contact with very mobile people investing in low-risk, low-capital trading activities, reflecting the unstable economic environment. OTL introduced solidarity group lending with women's groups from June 2000. The 'trust banks' methodology used by Opportunity International worldwide started in Dili with approximately 20 members per group, while the method was scaled down in rural areas to groups of five (Lynch, 2003). Despite a religious agenda in its microcredit operations, from the beginning OTL set interest rates to ensure future sustainability, and at the end of 2004 served approximately 3,000 clients, in Dili, Baucau, Liquica and Ermera districts.

Moris Rasik (in Tetum, "independent life") was established in 2000, supported by CASHPOR, the network of Grameen Bank replications in Asia. Moris Rasik lends to poor women in western districts, reaching 7,000 clients through 10 branches at the end of 2004. Moris Rasik is the largest and probably the most successful (98% repayment rate) microcredit provider, offering loans - mostly for trade - with six-month terms, and charging 20% interest annually. It remunerates savings deposits at 6% per annum. It has received funding from HIVOS (Netherlands), Grameen Foundation USA, AusAID, NZAID, USAID and several Singapore-based organisations, and has been audited and rated. Like other MFIs in Timor Leste, Moris Rasik is still a long way from reaching operational sustainability, with high operating costs related to the start-up phase and specific constraints of the environment. (Todd, 2004-2005)

Tuba Rai Metin ("Feet Firmly on the Ground" in Tetum) is supported by Catholic Relief Services, and provides microcredit through solidarity groups of three to ten members. It inherited the credit portfolio of Save The Children and operates in Dili, and in the eastern districts of Baucau, and Viqueque, reaching approximately 1,500 clients at the end of 2004.

NGOs with microfinance activities
Christian Children's Fund (CCF) works with local partners creating self-help groups in eight of the country's thirteen districts. It reached approximately 2,000 clients (borrowers and savers) by the end of 2004. CCF provides training and technical assistance to groups managing their own credit and savings operations. CCF uses a model in Baucau that targets at-risk youth, combining capacity building and loans to strengthen small enterprises. It has now been expanded to poor farmers. ***Hotflima***, originally supported by CARE Australia, encourages the development of self-help groups in three districts, serving approximately 1,400 clients at the end of 2004. ***Timor Aid*** started its post-conflict microcredit program conflict with funding from the Nobel peace prize of Jose Ramos Horta, Timor Leste's foreign affairs minister. Never geared towards self-sufficiency, Timor Aid's microcredit program faces major repayment problems, which seriously compromise its further development.

Support to microfinance
AusAID, the ADB and USAID have supported microfinance providers at different times. USAID supported the development of the Association of Microfinance Institutions in Timor Leste (AMFITIL), the network of microfinance providers active in advocacy for microfinance regulations, information sharing, and promotion of best practices. The association developed a code of conduct in response to a need for a consensus on a set of minimum performance and operational standards (AMFITIL, 2004).

Despite support from major donors, microfinance providers in Timor Leste still lack financial resources to sustain and develop their operations, especially the growth of their loan portfolio. Well-funded IMTL had plans to provide wholesale funds to microfinance providers, but that has not yet happened.

Competition among microfinance providers has started in some parts of the country, sometimes mediated through AMFITIL, and has resulted in a broader choice of services for clients (Hansen & Novanto, 2005).

Impact of the conflict on microfinance provision
Human resources
Microfinance providers had to cope with scarcity of skilled human resources, a consequence of decades of conflict and the Indonesian monopoly on all decision-making positions in the country. Consequently, microfinance providers had to invest heavily in paying expatriate staff while training and building the capacity of local personnel (Hansen, Todd, Iglebaek, 2005).

Financial infrastructure
The weak, nascent banking sector meant that MFIs had to carry higher costs and risks, especially for cash transactions in rural districts (Hansen, Todd, Iglebaek, 2005).

Physical and legal infrastructure
Damaged infrastructure and the occasional resurgence of civil disorder slowed the development of microfinance initiatives beyond Dili and the major towns. It also resulted in higher operating costs, lower self-sufficiency ratios, and a dependence on donors' subsidies. Poor infrastructure and an uncertain legal and tax regime have also been major barriers to growth for many microfinance clients, as the additional risks, financial resources and time required for trading activities reduced their capacity to repay loans.

Loss of trust
Many potential microfinance clients had lost trust in institutions, in themselves, and in their ability to make long-term commitments. The history of pro-Indonesia East Timorese militia also reduced trust within the community, further reducing the entrepreneurial ability to start and expand income-generating activities.

As a result, microfinance providers initially focused on short term, small loans for traders. Few people wanted to start productive or manufacturing activities, as they were looking for business opportunities with low upfront investment, and the ability to adapt their business to the rapidly changing needs of the emerging informal economy (Hansen, Todd, Iglebaek, 2005).

In addition, a number of MFIs had to decrease the size of client groups, as mutual guarantees were easier to enforce in smaller groups.

Impact of microfinance on conflict mitigation
OTL (Lynch, 2003) has found that microfinance could act as a catalyst for reconciliation and trust building. In group settings, borrowers had to guarantee each other, which placed them in situations where they confronted issues of trust and confidence. Other microfinance providers have also found that group-based activities encouraged trust building and self-confidence.

Conclusion

A selected review of the microfinance literature and a number of case studies has demonstrated that microfinance is not only an affordable, accessible source of finance providing powerful economic benefits in conflict-affected environments. It is also a tool for conflict resolution, social and political reconciliation, reintegration, and empowerment, leading ultimately to peace.

Microfinance encourages conflict resolution. By empowering members to establish their own organisation, microfinance integrates democratic procedures that help people surmount conflicts. For communities divided by conflict or caste, developing credit and savings associations could be a way to bring people together, focusing on economic activities and cooperation rather than differences.

Microfinance provided to different ethnic groups can also contribute to social and political reconciliation. It helps create a unified voice for peace, as people increase cooperation, build social structures with which all can identify equally, and work towards a shared future. The positive influence of rebuilding assets and developing trade also enhances reconciliation.

Microfinance encourages reintegration of refugees and demobilised soldiers. By providing microfinance to mixed groups including local community members with refugees and former soldiers, and demanding joint liability for repayment, prospects for reintegration are improved.

Microfinance providers have also found that group-based activities contribute to empowerment by allowing people to regain trust and confidence in each other. Groups can also discuss issues of tolerance and conflict resolution, and become catalysts in wider peace-building.

Thus, the benefits of microfinance in post-conflict situations go well beyond the economic, to the intangible, enhancing social capital and empowerment, and ultimately, contributing to peace-building and reconciliation.

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[1] The mission of the Foundation for Development Cooperation (FDC) is to strengthen partnerships for sustainable development and poverty reduction through action research, policy dialogue, advocacy and capacity building. Since 1991, FDC's microfinance program has aimed to explore, demonstrate and publicise the scope for increasing the access of the poor to microcredit, savings services and other financial services on a sound commercial basis.