Reparations and Microfinance Schemes

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1. Introduction: in search of sustainable impact of reparation payments

Once a transitional government has taken the difficult decision to issue reparations payments, or material compensation, to victims of human rights abuse, the question then becomes one of effectiveness. How should reparations payments be designed such that they best redress the claims of justice of victims and others, and ideally, facilitate a qualitative improvement in the daily lives of victims? As articulated by Pablo de Greiff, although reparations programs cannot restore the status quo ante for victims, they can still have a political, social, medical, and economic impact on the lives of victims, if as the chapters in this volume suggest, they are rooted in a long-term vision for society as a whole.

In many countries, self-help groups and indigenous informal savings and credit associations are the only civil society institutions that survive the breakdown of society. They represent the social capital[1] for the reconstruction of local financial institutions and even of local social relationships. In short, they are a potential resource for societies transitioning to democracies and coming to terms with past histories of abuse. The challenge for many transitional societies becomes utilizing existing social resources to achieve broader political and economic goals through making institutional commitments to acknowledge the past and construct a positive future.

2. The potential contributions of microfinance institutions

Designing reparations payments so that they contribute to such a vision and facilitate individual and societal investment in the future is an ambitious and in our opinion achievable goal if combined with a focus on microfinance institutions. The development of informal institutional frameworks that facilitate cooperation and collaboration within communities provide a structure for individuals to discuss and debate their visions for the future. For example, after establishing a community banking institution shareholders must choose among a variety of projects and enterprises, all of which have applied for a loan. Perhaps they decide to provide the first loan to a local farmer, increasing the food supply within the community. Perhaps the shareholders believe their most pressing need is education and provide the next loan to a trader specializing in school supplies and textbooks. Particularly in the beginning of the institution’s life, with each loan decision, shareholders make important decisions regarding the future shape of their community.

Moreover, experience in many countries has shown that, without an appropriate institutional framework, the benefits of one-time payments tend to be short-lived and unsustainable. There are two prerequisites of sustainable impact, which are mutually reinforcing: sustainable income-generating activities (IGA) and sustainable local financial institutions for the financing of such activities and other needs. However, in post-conflict and post-authoritarian societies, such institutions have been destroyed or disrupted.

[1] 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 & Seibel 2001)

In this study, the main focus is on the second prerequisite, ie, microfinance institutions (MFIs)[2], which in many countries have now evolved from unsustainable projects to sustainable organizations (Robinson 2001; Seibel 1996, 2001). There appear to be real opportunities to enhance the lives of victims through linking reparations payments to the development of microfinance institutions. MFIs are defined here as formal, semiformal or informal institutions[3] providing financial services (microsavings, microcredit, microinsurance) of a scale significantly below those of commercial banks[4] and to customers normally considered unbankable. One simplistic analogy for MFIs is a communal savings account. To belong to this informal organization, an individual must contribute to the communal account, typically referred to as "buying shares of the institution." The contributors become owners of the institution and can participate in the management of the MFI. The MFI uses these contributions to fund small-scale loans to individual members, with varying rates of interest that increase the overall cash holdings in the MFI. As the resources of the MFI grow from interest payments and newly–opened savings accounts, it is able to award a larger number of loans within the community, thereby supporting local entrepreneurship and development.[5]

By converting reparations payments into shares and beneficiaries into shareholders of microfinance institutions, the former victims turn into owners of sustainable local institutions: at the grassroots level of an emerging civil society. Microfinance, as a system of self-reliant local financial institutions – fuelled by reparation payments in addition to other resources –, can play a crucial role in sustainable economic and even political development.

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.

MFIs could 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;

[2] *Microfinance* was first introduced in 1990, referring to small-scale financial intermediation between savers and borrowers, moving away from a sole emphasis on credit. Meanwhile, the term has been used in many different ways. An MFI is thus not *a particular* type of institution, but *any* type of institution offering small-scale financial services to the poorer sections of society. Some now prefer the term *microbanking* to connotate small-scale financial intermediation along commercial lines.

[3] Formal financial institutions such as banks and finance companies fall under banking and corporate law and are supervised by the central bank or bank superintendency. Semiformal institutions such as credit NGOs and savings & credit cooperatives are officially recognized, but not financially regulated and supervised. Informal institutions of traditional or recent origin, among them self-help groups, are not officially recognized, but may fall under customary law. Any such institution is referred to as a *financial intermediary* if it mobilizes deposits and transforms them into loans.

[4] With regard to loan size, there is usually a wide gap between MFIs and commercial banks, the former most likely averaging in the hundreds and sometimes thousands of USD and the latter in the tens or hundreds of thousands of USD. Agricultural and other development banks frequently offer medium or large-scale as well as microfinance services. There is no way of generally defining microfinance in terms of size, as there is wide variation between countries.

[5] The by-laws of a rotating savings and credit association (ROSCA) among the Mano in the hinterland of Liberia is an example of how one member-owned MFI operates: "All members should agree upon one sum of money to be paid every Sunday. And one late to pay that Sunday five cents interest will be added to the sum he suppose to pay. Members should always put in the income; No matter how hard money business might be; you will have to put in the income. The five officers should agree before the money should be loaned to someone. Any money missing from the bank the Treasurer is responsible to pay for what is missing." Time for the income: Every Sunday. (Seibel & Massing 1974)

- 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 approach presented here applies to poor countries emerging from civil war, total crisis, or repressive regimes; and to situations where large numbers or clusters of people are eligible for reparations in the form of compensation. It is inspired by the concern for sustainable impact, in two respects: (i) Economically, reparation payments which are not invested profitably may be wasted and may deepen the existing sense of hopelessness. Investing them in MFIs creates a source of funding and initiates a process of sustainable growth from profits generated. Politically, investing reparation payments in MFIs is a way of facilitating a common future. It creates a network of relationships based on positive and repeated interaction. It creates ownership and control of institutions; this is fundamental and far more important than ownership of things material. Local financial institutions owned and controlled by the community or community members , after being trained in book-keeping and financial management, are among the basic building blocks of civil society. In this way, linking reparations programs to microfinance institutions can contribute to goals of recognition, civic trust, and social solidarity.[6]

Their potential for growth, if maintained over long periods of time, is unlimited. Although MFIs are particularly well suited to some post-conflict contexts, microfinance is not a poor solution for poor people in poor countries. In Germany, and similarly in other countries in the region, microfinance emerged from informal beginnings under conditions of extreme poverty but the resulting savings and cooperative banks now account for more than 50% of banking assets. This is the chance of reparation payments: to lay the foundation for the emergence of civil institutions which put large numbers of the poor into control of savings and credit as the fuel of growth and development.[7] The development of microfinance institutions can serve two crucially important goals for societies in transition: 1) it can increase the sustained effectiveness of reparations payments themselves; and 2) through its facilitation of decentralized economic authority, it creates alternative non-governmental sources of power and is a potential impediment to future abuses by the central government.[8]

3. The potential risks of a microfinance approach

The approach proposed here is novel. There is some experience with microfinance in post-conflict situations, but none with the use of reparations in building MFIs as instruments in a political or economic transition. At the outset, it must be acknowledged that linking reparations payments with MFIs creates risks for victims, many of whom suffer from poor physical and mental health as a result of their abuse. The basic premise of local microfinance institutions is that the initial loan recipients will indeed repay the loan and accrued interest on schedule. Particularly in a transitional context, when remnants of the old regime may still rule and institutional reform has yet to be enacted, local entrepreneurs operate in an uncertain context that threatens their ability to repay the loans. The social ties that make loan recipients accountable not only to the MFI, but to the larger community, are still in flux as individuals re-evaluate their relationship to their neighbors in light of the county's transition. Without an initially successful rate of repayment, the microfinance institution will fail those who most need it to succeed.

Second, MFIs are owned and managed by the community of shareholders. It therefore requires some knowledge of accounting and banking procedures, which may not be present within small rural communities. So in addition to the issuance of reparations payments, the

[6] See Pablo de Greiff, Reparations and Transitions to Democracy, in this volume.
[7] It should be noted that the author's personal experience in developing countries is limited to Africa, South and Southeast Asia, and the Middle East.
[8] This aspect of government economic and political control is explored more fully in Section 4: The microfinance revolution.

community will also require specialized training from either governmental or non-governmental authorities. Particularly as the institution grows, both in terms of capital and new members, the risk of failure increases unless continuing commitments for training are provided.

Third, similar to other cash payments, reparations may reinforce existing gender inequalities within society. The existence of new sources of power and authority, whether institutions or cash, inevitably inspires new attempts to control or secure it for oneself. Historically, women have frequently borne the brunt of this trend, as patriarchal societies either exclude them from management of the MFI or seize control of the payments issued to women. Strategies that aimed to increase rural women's access to credit have sometimes led to their exploitation as sources of capital and credit rather than their empowerment.[9] In contrast, there are numerous other cases where microfinance has given women unprecedented control, as for example in India where as of mid-2004 women constitute 90% of the membership in more than one million self-help groups linked to banks (Seibel & Khadka 2002; Karduck & Seibel 2004).

As the challenges above illustrate, failure of an MFI within a transitional justice context is not solely an economic event. Within the context of reparations payments, it has implications for the political project of building a new state and a common future. Just as the successful MFI can contribute to the key reparations goals of recognition, civic trust and social solidarity, the failure of the MFI can contribute to ostracism, generalized distrust, and the single-minded pursuit of self-interest. So while the potential benefits of linking reparations programs with microfinance institutions are great, so too are the risks.

Moreover, microfinance is no panacea; nor is there any single model that fits all cases. In each individual case, one has to study the local situation, examine the international experience, involve all stakeholders, and jointly arrive at an appropriate approach. While training, donor and stakeholder support, and a supportive transitional context can all reduce the risks inherent in this approach, they can not eliminate them. But reparations programs that include a microfinance component can build on decades, if not centuries, of history (Seibel 2003b) and lessons learned that illustrate how microfinance institutions can help to alleviate poverty, increase self-reliance, and improve peoples' quality of life.

4. The microfinance revolution

During the last two or three decades, there have been fundamental changes in development finance, captured by such terms as financial deregulation, development bank reform and the so-called microfinance revolution. These changes have led to a *paradigm shift* from subsidized targeted credit to financial systems development and institution-building, opening up a world of new options for agencies providing reparation payments to victims of human rights abuses. In particular, consensus has developed around certain principles (*best practices*[10]) with a dual concern for institutional sustainability and outreach to the poor.

Inspired by the success of the Marshall Plan in reconstructing Europe and rehabilitating its institutions after World War II, *capital transfer* emerged as the principal strategy of growth and modernization during the 1950s and 60s. This has shaped the economic environment of many developing countries until today, especially the poorest among them, by making

[9] Goetz, A., and R. Gupta. 1996. "Who takes the credit?: gender, power and control over loan use in rural credit programs in Bangladesh" *World Development,* 24, no. 1: 45-63.

[10] The term *best practices* has been disseminated by CGAP and the World Bank. It refers to a set of principles and should not be understood as a model that can be blindly replicated around the world. This author considers the latter a real risk and prefers the term *good practices* or *sound practices*, indicating that institutional solutions, while adhering to fundamental principles of viability and sustainability, invariably need to be developed, or adapted, within given cultural, social, economic and political conditions.

governments policy makers, bankers and investors. Yet, governments performed poorly in each of these tasks. Despite good intentions, government involvement in most countries resulted in totally inadequate financial infrastructures, the substitution of external debts for domestic resources, bank failures, and severe misallocation of scarce resources - all summed up in a single term: *financial repression* (McKinnon 1973*)*. Vested interests and perverse incentives kept the repressive system alive, benefiting a select number of politicians, public servants, bank staff and big borrowers.

Such policies also had political consequences of centralizing economic power in select hands and effectively undermining the emergence of alternative sources of power or authority. In many countries, financial repression was part and parcel of a larger political strategy, which relied on abusive tactics to maintain economic and political control.

Due to the dismal performance of development banks, many of the major donors, around 1980, pulled out their support, while governments found it increasingly difficult to provide budgets for loans that were not repaid. Many development banks collapsed or were technically bankrupt, which harmed the organizations and societies through which assistance had been channeled.

Instead, donor support, albeit on a reduced scale, shifted to non-governmental organizations (NGOs), particularly credit NGOs. They were supported by international NGOs and eventually also by bilateral and multilateral donors. This shift was initially not accompanied by a new paradigm: donors supplied the funds for loans; credit NGOs were not authorized to encourage voluntary savings; interest rates were subsidized; repayment rates were low; viability was abysmally low and self-reliance non-existent. The new concern with poverty alleviation seemed to justify the need for capital transfer and low interest rates. How could donors possibly expect the poor and the very poor to mobilize savings, build their own institutions, and invest their loans at profit rates that would enable them to pay market rates of interest and repay their loans on time?

Not surprisingly, many credit NGOs met with a fate similar to that of development banks, combining donor dependency with a lack of both sustainability and outreach. As in Ireland and Germany during the 18th and 19th century (Steinwand 2001; Seibel 2003b), it took some trials and errors to realize that, given the right incentives and institutional framework, the poor do save; they are responsible investors; they do repay their loans; and they may even own their financial institutions. It was also found that in many countries, women figure prominently among the prudent borrower-investors.

In an increasing number of countries, including some transitioning from abusive regimes, (e.g., the Balkans, Rwanda, Cambodia), there have been notable changes from the old world of directed credit to a new world of sustainable institutions. In this new world, governments make determined efforts to create a **conducive policy environment:**

- with new legal forms for local financial institutions,
- deregulated interest rates, and
- prudential regulation and supervision of financial institutions,
- paralleled by a deregulation of foreign exchange and the trade regime.

Responding to the demands of their customers, institutions reform and provide a variety of savings and credit services with the potential for income-generating activities, which generate funds to issue loans and expand. A number of agricultural and rural banks, cooperatives and other rural and urban MFIs have learned **to manage their risks by:**

- diversifying their portfolio,
- analyzing the investment and repayment capacity of the entire household,
- providing a range of appropriate financial services,

- starting small and granting repeat loans of increasing size,
- providing incentives to both staff and borrowers to enforce timely repayment,
- changing from group to individual loans and offering opportunities for graduation to larger loans as need be, and
- expanding into remote areas through linkages with self-help groups.

The transition from the old to the new world of development finance, as described below, is a challenging framework to any institution and donor agency aiming at sustainable poverty alleviation and development.

Table 1: From the old world of directed credit to the new world of financial systems development and institution-building: Do's and Don'ts

	Don't support :: *The old world of directed credit*	***Do support:*** *The new world of institution-building*
Policy environment	Financial repression	Prudential deregulation, development of financial systems
Legal framework	Lack of private MFIs	New legal forms for previously unregulated MFIs
Development approach	Supply-driven	Demand-driven
Institutional focus	Monopoly institutions	Various competing financial institutions
Clients perceived as:	Beneficiaries	Customers
Selection of clients	Targeting by donors and governments	Self-selection
Incentives for bank staff and borrowers	Perverse: leading to fund misallocation	Efficient allocation of funds
Regulation and supervision (R&S)	Cooperatives, MFIs, development banks unsupervised; donors keep distressed institutions alive	Microfinance units in central banks; regulation of rural banks/ MFIs; closing of distressed institutions
Agricultural finance	Lack of self-financing; restricted credit according to government directions	Self-financing from savings; external financing for profitable investments
Remote and marginal areas	Futile attempts of donors to drive ill-suited MFIs into remote areas	Self-managed savings-based self-help groups and cooperatives operating at low cost
Self-reliance	NGOs, agricultural development banks barred from deposit-taking; donor and government dependency	Self-financing through deposits and profits; institutional autonomy
Sustainability	Donors, governments fail to insist on performance standards and sustainability: lack of healthy banks	Increasing numbers of self-sustaining institutions of any type and ownership
Access to financial services	Very limited access to savings, credit, insurance.	Spectacular increase in outreach to the poor; profitable if interest rates are free

The promise of this new world of finance, for transitioning and stable regimes alike, has only just started. In most countries, the situation is highly complex and frequently contradictory. E.g., failing and prospering institutions may exist side by side; governments pass laws on market-driven institutions, yet continue subsidizing the interest rates of others; banks

mobilize large amounts of of excess liquidity[11], yet the government borrows money from international donors and increases its external debts.

Under adverse conditions, as in transitional situations, governments and donors tend to ignore all lessons taught (and evidently not learned), reverting to the old world of development finance. Driven by pressures to show impact immediately, it is tempting for agencies administering reparations to pursue centralized, government- or donor-driven policies. Yet, ***only the slow way of involving the victims of abuses as partners and owners in building sustainable institutions*** will lead to sustainable program impact: on both the victims in their capacity as micro-entrepreneurs and on the institutions they create.

Box 1: Requirements of sustainable microfinance
Sustainable financial institutions mobilize their own resources, provide financial services according to demand, cover their costs from their operational income, have their loans repaid, make a profit, and finance their expansion from deposits and retained earnings. *Resource mobilization* comprises equity, savings deposits, retained earnings and commercial borrowings, augmented by external resources such as soft loans and grants. Of these resources, three are fundamental to self-reliance and dynamic growth: savings deposits and equity including retained earnings. *Financial services* comprise credit for various purposes and savings deposit facilities; they may further include money transfer, check clearing and insurance. Insurance may serve the triple function of borrower protection, loan protection and resource mobilization. *Sustainable institutions* need an appropriate legal status which authorizes them to carry out all these functions; and they need to be properly regulated and effectively supervised. *Financial systems development* comprises processes of establishing a conducive regulatory environment (including a legal framework, prudential norms and effective supervision), an adequate infrastructure of viable small and large financial institutions, adequate demand-oriented financial products and good operational practices.

Experience around the developing world shows that virtually any type of financial institution, including commercial banks, can fail in the face of bad policy and bad management. On the other hand, experience also shows that any type of financial institution, once reformed and well-managed, can provide finance in a profitable and sustainable way for a wide variety of income-generating activities, emergencies and consumer purposes. Among the *flagships of rural and microfinance* are:

- Agricultural development banks like BRI in Indonesia, BAAC in Thailand, BNDA in Mali, CNCA in Burkina Faso, BNA in Tunisia, BK in Iran
- Specialized banks for the poor like Grameen Bank in Bangladesh
- Rural and community banks in Nigeria, Ghana, Tanzania, the Philippines, Indonesia
- Commercial mesobanks[12] like Centenary RDB in Uganda, CMF in Uganda, EBS in Kenya, Banco Caja Social in Colombia, Micro Enterprise Bank (MEB) in Bosnia
- Member-owned financial cooperatives like SACCOs in Kenya and Tanzania, credit unions in Madagascar, People's Credit Funds in Vietnam, Small Farmers Cooperatives Ltd. in Nepal, savings and credit cooperatives in the Philippines
- NGOs like CHF/JACP in Jordan, UMU in Uganda, EKI in Bosnia, ASA in Bangladesh
- Credit-NGOs establishing banks like SEWA in India, ACLEDA Bank in Cambodia, CARD and others in the Philippines, Bina Swadaya and Purba Danarta in Indonesia, K-Rep in Kenya, BancoSol in Colombia, Compartamos in Mexico

[11] Eg, since 1995, the Microbanking Division of Bank Rakyat Indonesia has been producing annually between US$ 1 and 1.5 billion in excess deposits (over and above the amount lent).

[12] *Mesofinance* is a new term suggested here to connotate the next rung on the ladder of institutional size, referring to financial services beyond the scope of most MFI but still far below that of commercial banks. One implication is that, given a general reluctance against joint liability beyond a certain magnitude of loans, mesofinance mostly refers to individual loans backed by collateral rather than peer guarantees. Collateral may be formal or nonformal, but is likely to be more formal if larger and longer-term loans are involved.

- Member-owned village funds like sanadiq (sg.: sanduq) in Syria, caisses villageoises/village banks in numerous countries
- Member-owned self-help groups as autonomous financial intermediaries linked to banks in India, Indonesia, the Philippines, Nepal, Nigeria, Burkina Faso, Mali.

These institutions rely on four commercial principles for their success:[13]

- mobilizing financial resources locally;
- having their loans repaid;
- covering their costs;
- and financing the expansion of outreach from deposits and retained earnings.

5. Dilemmas in the designing of a reparations-microfinance framework

In recent years large numbers of developing and transitional countries experienced situations of *crisis*, following political, economic or natural disasters, or *total crisis,* triggered by war or totalitarian oppression, in which the very structure of society has been put out of function. In a total crisis, the state virtually ceases to exist, national economies disintegrate, and social and political structures melt away. A significant number of people are exposed to a day-to-day struggle for survival, often separated from their homes and deprived of their usual sources of livelihood. In particular, total crisis means that, national governmental and civil society organizations have been destroyed; the production and market distribution of goods and services has been disrupted; 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; and large numbers of individuals have been physically and socially displaced and were subject to traumatizing experiences of violence. The problems are almost too numerous to name, and combined, they create a context that threatens not only the viability of a reparations program, but also society's larger transition to a functioning, just, and peaceful state.

It is within this context that designers of reparations programs face intense and difficult decisions, such as whether to make microfinance institutions a mandatory aspect of the reparations programs and how victims and perpetrators should relate to one another within this process.

Governments face immense financial and political hurdles in designing reparations programs, which often leads to a governmental preference for collective reparations programs. Collective payments and programs allow them to spend less per individual, while still providing reparations to the majority of victims. Through collective programs, the government recognizes that pain and suffering occurred, although for victims, this falls short of recognizing their individual pain. The use of collective grants may also allow governments to label existing infrastructure and development funds as reparations funds, thereby enacting a reparations program with little additional expense. While this may occur because the transitional government is simply not committed to a reparations program, it is also an understandable attempt to stretch limited budgets and make each dollar count twice.

Governments also usually prefer to provide services in kind, rather than direct cash payments. Similar to stable regimes, some proponents of in-kind services don't trust recipients to spend cash payments as intended, despite numerous studies that show cash payments to be more efficient economically and socially. Other proponents stress the state capacity-building aspects of in-kind services. Providing services such as health care can

[13] It should be noted that these principles are not new in rural and microfinance. In the absence of external support, they have always been fundamental to indigenous informal financial institutions around the world.

simultaneously create employment and strengthen the state system while caring for victims of the past regime. The issuance of direct cash payments, while perhaps providing an economic lift through consumer spending, does not have nearly the same state-strengthening effect as in-kind services. Through the provision of services, instead of cash, the government in effect invests in itself and builds its own capacity to be an effective state, while caring for the needs of victims.

Both of these preferences, for the collective and service or in-kind benefits, can lead to development policies that masquerade as reparations programs. Yet, as other chapters in this volume affirm, victims of human rights abuse have a right to reparations above and beyond their right as citizens to development initiatives.[14] Simply put, governments will significantly harm the political and social aims of reparations if they substitute the provision of clean water for reparations programs. Moreover, the reparations payments have a value above and beyond what they can materially purchase. In many societies, cash implies a tangible commitment to repair past wrongs – particularly when compared to lofty but unimplemented goals and inspirational speeches. Hence, in a variety of ways, government preferences may conflict with preferences of victims and indeed, the original aims of the reparations program.[15]

Within this context, there are several scenarios for introducing microfinance institutions as part of a reparations program. States could issue collective grants to villages and sub-districts to be used as start-up capital for a local microfinance institution. All members of that particular community would become immediate shareholders and eligible for savings accounts and small-scale loans. Although no solution can be absolutely perfect, this option presents significant difficulties. First, it fails to distinguish between victims and those who did not suffer directly, or worse, those who aided or participated in the abuse. Therefore, this option may be more successful when abuses targeted particular areas or when victims are concentrated in certain locations, such as townships or rural homelands. Second, because community members do not consciously choose to take part, this option can reduce the sense of local ownership and responsibility. The implications of this may vary from diminished perceptions of self-help to the failure of the MFI because members were not personally invested in the outcome.

In the second scenario, governments could issue smaller collective grants to villages or sub-districts as the start-up capital for local MFIs, but also individual cash payments, with which they may choose whether to buy shares or open accounts in the newly created microfinance institution. Those who did not receive cash payments would have the option to buy shares as well, but no one would be required to participate. This option does recognize individual suffering, but also provides a neutral space where, finances permitting, other members of the community may also participate. Low-level perpetrators would indeed be allowed to participate, but their cash contribution to an organization that at least initially would be owned by victims can contribute to restoring inequalities of power within the community. Particularly for victims that have suffered abuse which led to their subsequent ostracism, such as disfigurement, amputation, or rape, these types of institutions can promote social inclusion and participation by facilitating inter-personal contact.

Last, governments could issue individual grants with the advice that victims should use those funds to create a local MFI and buy shares. As in each of the scenarios, the government could provide training and assistance, directly or via NGOs, throughout the country to facilitate the creation of the MFIs. Of course, the difficulty here is that MFIs require a minimum number of members to be financially viable, depending on the amount of the cash payment. If the majority of cash recipients choose not to participate, this denies others who may wish to buy shares the opportunity to do so. This option is also the least preferred by

[14] Ref. to de Greiff and Segovia.
[15] Ref. to Hamber.

governments who hope to wring political, social, and economic results out of reparations programs.

6. Microfinance strategies: Delivery Mechanisms and Sustainability

Prerequisites of sustainable impact
In addition to delineating what kinds of benefits victims will receive, it is equally important to decide how those benefits will be delivered. The method of delivery, in this instance, of cash payments can impact the political goals of the reparations program through their economic impact on the lives of victims. As we have argued throughout this paper, having a sustainable economic impact increases the probability that the reparations program will meet its political aims.

For a sustainable impact, the following conditions have to be met:

- profitable investment of payments in income-generating activities[16];
- access to deposit facilities for the safekeeping and accumulation of savings (derived from reparation payments and profits) as a source of self-financing;
- access to credit (at commercial rates) as a source of external financing;
- the repayment of loans on time as a prerequisite for repeat loans of increasing size.

There appear to be four delivery vehicles for issuing reparations payments to victims: 1) Direct payment through specialized agencies; 2) Payment through commercial banks; 3) Payment through credit NGOs; or 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.

Direct payments through specialized agencies, channeling funds on a temporary basis, 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 notwithstanding[17], 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, e.g., through sizeable minimum deposits and unfriendly treatment.

As the example above illustrates, economic sustainability is not the only factor in choosing a suitable delivery agent for issuing reparations payments. Disrespectful or denigrating treatment by the delivery agent will negatively affect the victim's overall perception of the reparations program.[18] In addition, the type of delivery agent chosen will impact how involved and empowered victims feel in the founding of their local MFI. For example, if recipients receive reparations payments along the same lines that they receive their social welfare assistance, then payments are more likely to be perceived as state charity instead of state obligation.

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[16] 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,

[17] 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: 2).

[18] As seen in Ariel Colonomos' case study, this is a common criticism of German reparations post-World War II for "harm to health." Victims felt the examination procedures (required to qualify for reparations) and in some instances, the subsequent care provided was humiliating and demeaning.

In most post-crisis situations, NGOs are the major agencies of providing financial services. 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 have a number of strengths, which are of particular importance in countries destroyed or distressed by crisis:

- they are easily and quickly established and do not require a complex legal framework;
- given their orientation to poor target groups, they are able to communicate with the poor and distressed;
- and they are flexible in providing a range of services, including, in addition to finance, microenterprise training and consultancy as well as education, health care, counseling and others directly related to demand and felt needs.

Yet, some of the strengths of the NGOs are also their weaknesses First, while NGOs are 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. Donor dependency and lack of self-reliance in terms of operational and loanable 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. In addition, without legal status and effective regulation & supervision, this has invariably taken an inordinately long time and eventually hit a barrier of growth which only well-managed and properly supervised financial institutions have overcome.

This first weakness of credit NGOs is surmountable, as evidenced by the transformation of credit NGOs to rural banks in Sierra Leone, the Philippines, and Uganda.[19] Issuing reparations payments through credit NGOs can lead to economically sustainable outcomes for a large number of recipients, if these NGOs plan for their eventual conversion into a formal institution.

The second weakness of NGOs – lack of local ownership and transparent governance -, however, has yet to be successfully overcome. As a result, there is little orientation towards profit-making and growth and no accountability for losses. The problem of ownership for credit NGOs is also complicated by donor involvement. One solution would be cooperative ownership by the clients; this however has rarely been accepted by the board and management of NGOs. Converting credit NGOs into member-owned institutions may be a desirable option, but does not seem to meet with much sympathy among their donor-stakeholders.

So although credit NGOs can facilitate the issuance of reparations payments, they fail to achieve many of the political goals of reparations programs. The collaborative and interactive processes of institution-building and allocating loans are processes that belong to owners, not users. If stakeholders can not meaningfully participate in the direction and

[19] From Sierra Leone to the Philippines to Uganda, a new generation of credit NGOs are transforming themselves into sustainable microfinance institutions. *Finance Salone* in Sierra Leone will remain under the international management of the American Refugee Council initially, but they are already planning for *Finance Salone* to be "spun-off" within three years and registered as a local microfinance institution, managed by national staff. With professional local staff and national outreach, *Finance Salone* will be operationally self-sufficient by 2007 and financially self-sufficient by 2009. The Center for Agriculture and Rural Development (CARD) in the Philippines has successfully transformed itself from a credit NGO to a sustainable rural bank using group-lending techniques pioneered by the Grameen Bank in Bangladesh. Similarly among the credit NGOs in Uganda, there are some 40 or 50 large ones, which may now take advantage of the recently prepared microfinance law and convert into regulated deposit-taking institutions; or directly into a commercial bank, like Centenary RDB. Other examples of banks of NGO origin are BancoSol in Bolivia, Bank Purba Danarta and numerous other NGO banks in Indonesia. For more on these examples see (CGAP (2002/6) and (ARC 10/2002) for Sierra Leone; Seibel and Torres, 1999 for the Philippines, and Seibel 2003a for Uganda.

purpose of their microfinance institution, then linking microfinance institutions with reparations programs is of little value politically.

6. Investing in local financial institutions: the contribution of reparation payments towards sustainable institutional rehabilitation and capacity-building

> *One of the biggest mistakes often made in a post-conflict environment is the focus on speed of loan disbursement. Getting money out the door quickly often entails a very limited institutional development focus, which is the core behind best practice microfinance principles. By not focusing on institution building, projects often pollute the environment for those who are attempting to abide by best practice microfinance.*
> *(CGAP, Microfinance Policy Review Sierra Leone, June 2002, p. 24)*

Types of local financial institutions

A different approach, with ownership clearly established from the onset, would be to support locally owned financial institutions, (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. There are three major types of locally owned institutions:

Member-owned institutions based on *social solidarity* (de Greiff 2003:22) are typically self-financed and self-managed. They can be formed by any type and number of people within or across neighboring communities, comprising microentrepreneurs, small farmers, women and the poor. Membership is normally contingent upon an equity capital contribution but may also include other criteria (e.g. gender as in the case of a women's bank, occupation as in the case of a market or traders' bank) and is a prerequisite for access to the institution's services. In some cases such institutions are also open to non-members but at different terms. Member-owned institutions 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 many indigenous savings and credit associations and in the ASF 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. There must be a provision in the rules and regulations or bylaws 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 *government-based*, be they government-owned or government-imposed and perceived as government institutions. 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.

Privately owned financial institutions are owned by one or several wealthier individuals. Examples are the rural banks in the Philippines and Indonesia. Sometimes they are owned

by large numbers of not-so-wealth individuals, with shares similar in size to those in cooperatives. The difference lies in governance: cooperatives are governed by the principle "one man, 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.

Strategies of promoting locally owned financial institutions: upgrading, innovating, linking[20]

Informal financial institutions (IFIs) of indigenous origin are widespread in many developing countries, particularly in Africa and Asia.[21] Organized self-help is part of the social capital of almost every ethnic group, comprising a range of institutions referred to by terms in the local language. In a stable environment, they typically mobilize their own resources, cover their costs, have their loans repaid, and finance their growth from their profits. They are generally renowned for the effectiveness of social control. There are two types: individual intermediaries, such as money-lenders and deposit collectors; and indigenous group-based intermediaries.The emphasis here is on the latter, i.e., self-help organizations owned and managed by groups of local people, poor and non-poor.

When the state with its institutions collapses, institutions that are part of the traditional fabric usually remain. In fact, in the absence of other options, indigenous institutions may gain in outreach and vigor. In many parts of **Ethiopia** for example, *edir*, the ubiquitous funeral society, has evolved during the crisis years into a village-based financial institution with a range of innovative financial services to its members. Some NGOs, like the Norwegian Redd Barna, have built on that basis.

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.[22]

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.

[20] Downgrading or downscaling commercial banks is a fourth microfinance development strategy. This is not discussed here, because it would be illusionary to request co-ownership by local people. (Seibel 1997)

[21] The institution of rotating savings is ancient, dating back at least to the 16th century, when Yoruba slaves carried it to the Caribbean, as part of their institutional luggage – or social capital. Both the term *esusu* and the practice have persisted to this day, as *esu* in the Bahamas, *susu* in Tobago or *sou* in Trinidad. Among the Yoruba in Nigeria today, there is hardly a single adult who is not a member in one or even several esusu, numbering anything between two and several dozen or even hundreds of members. The institution exists all over West Africa as well as in many other parts of the world, where it is an integral part of the local microeconomy and referred to with its own vernacular term, eg, *arisan* in Indonesia, *paluwagan* in the Philippines, *gameya* in Egypt, *ekub* in Ethiopia, and *cuchubal* in Guatemala. Substantial changes have occurred in recent decades. Although with no predetermined pattern, these changes have tended to be in the following directions: from labour, kind or premonetary currency, to cash; from non-financial to financial groups; from rotating to nonrotating patterns; from short-lived to permanent groups; from savings only to savings-driven credit. With the expansion of the money economy, they have multiplied, both in number and diversity. (Seibel 2001/4:84-85)

[22] Williams et al. 2001; Wilson 2002.

Where informal financial institutions are lacking, new **financial service associations (FSAs)** can be established.[23] FSAs are built on the principles of indigenous nonrotating savings and credit associations: proximity, local financial intermediation, ownership and self-management by the poor, self-reliance, and sustainability. Thus, the FSA concept is a flexible model of microfinancial intermediation in rural areas, resting on member-owned financial structures that are initiated, owned, and operated by the villagers themselves. In the restrictive policy environments, many FSAs have preferred to remain informal rather than register as savings and credit cooperatives, which are regulated by the law. Operating outside any formal regulation and supervision certainly is a risk to their growth and long-term sustainability; but during the start-up phase, this would be an advantage in post-conflict situations where a formal institutional framework has yet to evolve. (Seibel 2003c)

Sanadiq (pl.; sg.: ***sanduq***), a concept based on ancient Arab traditions, are member-owned local financial institutions in **Syria**, a command economy where all banks have been state-owned. With a mixture of member-equity and external equity contributions, the sanadiq have been shaped in their structure and functioning by the local people in Jabal al-Hoss through an intense participatory process and not by any authorities. Support has come from the Ministry of Agriculture and Agrarian Reform and UNDP. It is not rare that women – among them a mother of ten - are the better entrepreneurs, perhaps ushering in a small social revolution. (Imady & Seibel 2003) [24]

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.

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:

- mobilizing local resources through member-owned local financial intermediaries and providing access to credit from commercial sources;
- integrating these SHGs/IFIs into national financial markets;
- enabling banks to reach out to smallholders and microentrepreneurs as a new market segment.

Linkage banking has widespread economic and political benefits for societies recovering from massive histories of abuse. It can reduce the transaction costs of lenders and borrowers and simultaneously of deposit-takers and depositors. NGOs and other non-financial organizations have contributed to social mobilization, training and consultancy services; some have also acted as financial intermediaries in the inception stage when banks lacked confidence in informal groups. SHGs also deposited substantial amounts of savings voluntarily in banks as reserves. In addition to direct effects on bank profits, SHG Banking has *indirect commercial effects* on banks in terms of improved overall vibrancy in banking activities. *Indirect benefits* at village level include the spreading of thrift and financial self-reliance and of a credit culture among villagers, microentrepreneurial experience, growth of assets and incomes, the spreading of financial management skills, and the decline of private moneylending. *Intangible social benefits* are reportedly many: self-confidence and empowerment of women in civic affairs and local politics, improved school enrolment and women's literacy, better family planning and health, improved sanitation, reduction of drinking and smoking among men, and a decline in adherence to local extremism.

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[23] Promoted by the International Fund for Agricultural Development (IFAD), a UN agency.
[24] .For further details and a pictorial view see www.undp-hoss.com.

7. Conclusion: New Opportunities

Whether building on local custom or establishing new informal institutions, a growing body of evidence shows that MFIs are an important part of building sustainable economic futures. Designers of reparations programs can take advantage of these positive outcomes by linking the issuance of reparations payments to the establishment or development of microfinance institutions. Moreover, if successful, the development of MFIs will further the political aims of the overall reparations program and contribute to a qualitative improvement in the lives of victims.

The use of microfinance institutions also presents new opportunities to external donors to contribute to reparations programs.[25] As the case of El Salvador illustrates, external donors are extremely reluctant to fund reparations programs directly. In part, this stems from the conviction that the state should fund reparations itself, as a sign of good faith and apology. It also reflects more general donor imperatives to fund initiatives that will be popular at home, and ideally initiatives that can be captured in a photo prominently featuring the donor country's flag. However, external countries may be more willing to contribute funds to communal savings accounts and facilitate self-help programs.

The economic and political choices in designing sustainable reparations program are complex, yet the potential contribution of sound and effective programs compels us to investigate new approaches. While the approach in this chapter has never been attempted, there are a variety of lessons to be learned from post-conflict development, rural development programs, and the growing field of microfinance. The combination of these insights presents a unique challenge to designers of reparations programs to incorporate the economics of sustainability into political programs for social change.

[25] The financing of reparations programs is explored more fully in Alex Segovia's chapter for this volume.

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