Session 5.4
Financing Post-Conflict Recovery

Risky Business in Bougainville: Implementing Microfinance in Post-Conflict Environments

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Microfinance can be harnessed to serve both relief and development purposes in post-conflict environments, supporting survival, reconstruction and social reconciliation objectives in the immediate conflict aftermath, as well as longer-term economic re-building through microenterprise development. Within the microfinance industry commercialisation is widely viewed as a desirable goal, and a number of donors are building commercialisation objectives into their support for post-conflict microfinance programs. The appropriateness of the commercial paradigm in post-conflict environments is questionable, however, given the high operating costs faced by post-conflict microfinance agencies, weak demand for most profitable microfinance services, and limitations on rapid improvements in local economic capacity, particularly in remote areas. This paper reviews the issues raised by commercialisation in post-conflict environments, with particular reference to a microfinance scheme in Bougainville, a province of Papua New Guinea currently in recovery from a prolonged period of armed conflict.

1. Introduction

Provision of development aid, as distinct from short-term humanitarian assistance, in post-conflict environments (PCEs) is an issue that has lacked adequate attention and reflection within the development and aid literature. Microfinance – the provision of small-scale financial services to low-income clients – can be harnessed to serve both relief and development purposes, supporting survival, reconstruction and social reconciliation objectives in the immediate conflict aftermath, as well as longer-term economic re-building through microenterprise development. Microfinance programs which are introduced early can play an important role in the transition from relief to development. In the mid-1990s some microfinance institutions (MFIs) began to extend their operations into what the industry defines as "difficult environments": communities in which HIV/AIDS is endemic, or in recovery from natural disaster or armed conflict. Since the mid-1990s microfinance interventions have been implemented in several post-conflict countries including Rwanda, Mozambique, Cambodia, Bosnia and Kosovo.

Since the mid-1990s the dominant paradigm within microfinance has been the "financial systems" or "institutionist" approach, which envisages an industry dominated by large, profit-seeking microfinance institutions (MFIs) which meet their costs from interest and fee revenue, and obtain their capital from savings mobilisation and commercial finance markets rather than subsidised donor funds. While mainstream opinion within the microfinance sector tends to favour the institutionist approach, there is ongoing debate over its appropriateness as a universal blueprint, with concerns that in the push towards commercialisation, MFIs are at risk of forgetting their original social and poverty reduction objectives (Woller et al 2001, Morduch 2000). Evidence that very poor clients are willing and able to pay full cost-recovery interest rates demonstrates that commercialisation is a realistic goal in a variety of development contexts. It is likely to face significant constraints in PCEs, however, given high operating costs, weak demand for most profitable microfinance services, and limitations on rapid improvements in local economic capacity, particularly in remote areas.. Nevertheless, a number of donors have sought to apply the institutionist model in post-conflict interventions, building financial self-sufficiency objectives into their support for post-conflict MFIs (PCMFIs).

As the post-conflict trauma subsides, with the return of stability, normalisation of social relations and rebuilding of infrastructure, it is likely that improvements in operating conditions will reduce costs and facilitate the scaling up of outreach and services, allowing MFIs to move progressively towards self-sufficiency. The pace of such progress is likely to depend on contextual factors such as the state of the economy and the composition of the client base. The extent to which program design features mediate trade-offs between institutional efficiency and social objectives is likely also to be a key factor. Although there is an extensive general literature on microfinance "best practices" aimed at facilitating financial self-sufficiency, "best practice" program design in a post-conflict context remains a largely unexplored field.

As post-conflict microfinance interventions are relatively recent, there is little data on the impacts of commercialisation on PCMFI operations and clients. Issues in the application of an institutionist model to PCMF will be explored in a forthcoming research project examining a microfinance scheme in Bougainville, a province of PNG currently in recovery from a prolonged period of armed conflict. In the aftermath of a ten-year civil war, the Bougainville Microfinance Scheme (BMFS) operates in a typical PCE, characterised by the widespread destruction of physical infrastructure and human support systems, displacement of families, ongoing pockets of armed conflict and a severely traumatised civilian population. Supported by the official Australian aid agency, AusAID, the BMFS since 1998 has provided smallscale savings and loans services to conflict-affected communities. To date, AusAID support has focused on training and capacity-building for program staff. From the end of 2004, the proposal is to expand the program with a substantial injection of donor "seed funds", and thereafter to shift the funding base towards a commercial footing.

This current paper describes the context in which the BMFS operates and discusses some broader issues. The second section briefly reviews the debate on commercialisation. The third section discusses the issues and constraints facing microfinance in PCEs. The fourth section describes the background to the Bougainville conflict and highlights development issues facing Bougainville in the post-conflict period. The fifth section describes the BMFS before conclusions are drawn in the final section.

2. Two views on commercialisation

In the 1990s two views emerged on the extent to which MFIs should aim to finance their operations without recourse to donor support. Practitioners distinguish three levels of financial sustainability. At the lowest level, *subsidy dependence*, an MFI is unable to cover any of its costs and relies entirely on donor funds. At the second level, *operational self-sufficiency* (OSS), the MFI covers its operating costs (i.e., salaries, administrative overheads, training and other non-credit services) from fees and interest revenue, but relies on subsidised capital for on-lending). At the highest level, full *financial self-sufficiency* (FSS), the MFI is entirely independent of donors, meeting its operating and capital costs from deposit mobilisation and/or commercial financial markets. Most observers agree that as a minimum requirement, MFIs should strive for OSS, aiming to earn enough revenue from fees and loan-interest to cover their day-to-day operating costs, but disagree on whether, over and above OSS, MFIs should meet the more demanding criterion of FSS.

Current donor opinion holds that MFIs can and should aim for full commercial viability, arguing that microfinance is better served by market-based approaches than concessional donor support. They see a limited role for donor support in financing MFI start-ups and supporting technical and managerial progress towards FSS, but argue that in the long run, limitations on the magnitude and durability of donor support mean that broad, sustainable outreach can be achieved only by accessing commercial funding sources (Gibbons and Meehan 1999). In addition to constraining sustainability, it is argued that reliance on subsidies has other undesirable effects, leading MFIs to focus on maintaining the subsidy rather than the needs of their clients, and, where donor funds are used to subsidise interest rates, generating a negative credit culture in which loans are viewed more as grants by borrowers (Barry 1995). For institutionists, the main role of donors is to assist in building FSS institutions: having assured viability in one, they can move on to the next. Thus, many MFIs receive donor funds on the premise that external assistance is a temporary measure and that they will eventually become entirely self-funding, and the progressive achievement of FSS benchmarks is a condition of continued donor support.

Major donors such as the World Bank's CGAP program and USAID, which are strong advocates of the institutionist position, support research and development programs aimed at identifying and promoting "best practices" which facilitate commercialisation. A key theme of the best practices literature is the setting of fees and interest rates at full cost recovery levels which, given the cost structures of microfinance, are usually well above standard bank lending rates (Rosenberg 2002). Other themes focus on cost reduction through improved operating efficiency, the cutting of unprofitable "non-core" services, and the identification of clients based on profitability rather than need. Thus, best practices oppose the idea of targeting services to specific sectors or client groups, and favour "minimalist" rather than integrated service provision, excluding non-financial social intermediation and microenterprise support services, and unprofitable financial services, in favour of an exclusive focus on more profitable financial services.

The institutionist view is opposed by the "welfarist" school, which holds that microfinance programs often serve social objectives which justify ongoing donor support. Welfarists are concerned that in the push towards commercialisation, influential donors are steering MFIs in a policy direction which is inconsistent with their underlying social objectives. They argue that profit-maximising MFIs tend to move away from poor, high-risk client groups. Because loan transaction costs are a more or less fixed quantity regardless of loan size, and as the most disadvantaged groups are relatively difficult to reach and likely to require additional services, programs concerned with their financial bottom-lines have a powerful incentive to avoid them in favour of larger, cheaper, lower-risk loans to non-poor clients. They point out that subsidies are necessary to support non-financial services such as training, business development and social intermediation, which by themselves are unlikely to generate commercial rates of return. Unless these activities are subsidised they are likely to be reduced or discontinued by commercially-minded MFIs, with adverse impacts on the poorest and most marginalised, who tend to be the main beneficiaries of non-financial services.

Furthermore, they argue that a "one size fits all" commercial model ignores the diversity of microfinance services and of clients who can benefit from microfinance. They agree that there is room for commercially viable MFIs which target the less poor. Fully commercialised business-oriented programs may generate significant social benefits by serving a neglected market segment of relatively well-off clients, who can pay commercial interest rates but are excluded from the formal banking sector. But there is also a place for donor-funded programs which operate from humanitarian motives and which are not commercially profitable. The two should not be confused, however, and there is a danger that pressures for the adoption of commercial practices will compromise the effectiveness of poverty-focused programs.

Expectations that all MFIs can become commercially viable may be excessively optimistic. In practice few MFIs meet strict tests of financial sustainability even after a decade or more of assistance. While some high-end, large-scale MFIs, notably in Latin America, have achieved complete FSS, the majority are likely to remain in receipt of donor funds in the foreseeable future. A recent cross-country survey of 124

MFIs found that while most had achieved OSS, only 66 had attained FSS. (Microbanking Bulletin 2003). The empirical evidence offers some support for the welfarist claim that commercialisation may compromise poverty reduction and social objectives, with findings that programs with explicitly social objectives are the least likely to cover their own costs (Hulme and Mosley 1996, Morduch 2000), and FSS institutions are less likely than other MFIs to target poor clients, and more likely to be profit-seeking rather than mission-driven organisations ((Microbanking Bulletin 2003).

3. Commercialisation in PCEs: a feasible option?

While many post-conflict priorities – such as political and economic stabilisation, restoration of the law and order framework, the rebuilding of public infrastructure and social services - require macro-level interventions which are well beyond the scope of microfinance programs, PCMFIs can support a number of community-level and household-level objectives. There has been increasing interest in the potential of microfinance to combine income promotion with survival and reconciliation objectives in PCEs. Promotional (income enhancement) and protectional (vulnerability reduction) objectives are primary, first-order goals for microfinance, and social capital building is generally seen as a complementary, second-order goal (Doyle 1998). The interest of practitioners in social capital stems largely from the importance of mutual trust and cooperation networks in the effective functioning of microfinance programs. In PCEs, however, where reconciliation and the revival of cooperative activity are key community development priorities, the social capital-building functions of microfinance are accorded greater prominence.

Promotional approaches, which have traditionally dominated microfinance and remain the primary goal of most MFIs, aim to move borrowers "from a stable 'below-poverty-line' situation to a stable 'above-poverty-line' situation" (Hulme and Mosley 1996:106). They aim for sustained improvements in household incomes through microenterprise development, and their strategic focus is on microenterprise lending, sometimes supported by non-financial business development services such as training and technology transfer. By contrast, the primary objective of protectional approaches is not to increase incomes but to reduce economic vulnerability by ensuring continuity of access to basic needs through periods of crisis.

There is considerable evidence that microfinance can play an important protectional role in PCEs, through the provision of savings facilities and small, short-term loans which finance consumption, the retirement of more costly debts, housing and household asset purchases, subsistence production and risk-spreading diversification of household income sources into multiple low-value income-generating activities (Sebstad and Cohen 2000, Doyle 1998, Wilson 2001). Protectional microfinance may also complement non-financial interventions aimed at other key priorities such as food security and the empowerment of particularly disadvantaged groups. As women and female-headed households are among the most vulnerable, and because of the importance of income controlled by women in reducing intra-household inequalities in consumption, the social and economic empowerment of women is a key protectional strategy. Furthermore, protectional microfinance may provide a first step towards the re-building of livelihoods, assisting clients to reach a threshold of income security from which they can launch higher-risk, higher-return income-generating activities (Hulme and Mosley 1996, Sebstad and Cohen 2000, Zaman 1999). Thus there is a case for sequencing post-conflict microfinance interventions to focus initially on protection and subsequently, with the rebuilding of household asset bases and revival of economic activity, to shift the focus towards sustained income promotion (Doyle 1998:27).

“Social capital” refers to norms and networks that foster trust, reciprocity and cooperation, thereby enhancing both efficiency and well-being. Social capital development is both a precondition for and outcome of microfinance. The great innovation of microfinance, which makes it possible to extend services to groups viewed as unacceptably high risks by formal financial institutions, lies in its substitution of physical collateral with joint liability arrangements, in which each borrower’s loan is guaranteed by her peer group members. Social capital increases the ability of borrowers and lenders to participate in transactions which involve an otherwise unacceptable degree of risk, by improving the level of information each has about the other, and potentially expanding the range of enforcement mechanisms for dealing with loan delinquency where recourse to the legal system is costly or impractical (Narayan and Pritchett 1997). In addition, it reduces transaction costs for the lender by transferring loan appraisal, approval, monitoring and collection functions to cooperative peer groups (Ito 2003).

Conversely, the use of solidarity lending and group meetings in microfinance facilitates the building of social capital (Anderson and Locker 2002). The social capital building role of microfinance is particularly important where programs seek to empower women and other marginalised groups through the establishment of solidarity networks (Rankin 2002, Barnes 1998). While practitioners are cautious about the use of microfinance interventions to “engineer” reconciliation in PCEs, there is support for its use as a tool for reconciliation and the facilitation of grassroots cooperation, and evidence that peer group processes contribute to inter-ethnic cooperation between members, their neighbours and families (Doyle 1998, USAID 2001). The targeting of women is believed to promote reconciliation objectives through their empowerment as peace-makers (Doyle 1998).

MFIs in PCEs face higher costs their non-conflict counterparts. Weak social cohesion requires PCMFIs to invest heavily in social capital building. Demand for institutional financial services is often low, in part because low levels of intra-community trust lead to reluctance to participate in solidarity lending and savings schemes (Doyle 1998, Wilson 2001, Williams et al 2001). Group-based methodologies require members to manage funds and maintain records, and to possess good information about other members. Where financial skills are scarce or, as in situations of high population mobility or unresolved intra-community tensions, levels of trust and information are low, groups may take some time to become functional, requiring extra social mobilisation efforts (Kuehnast 2001, Doyle 1998, Nagarajan 1999).

Staffing costs tend to be high, with the depletion of human resources, high competition for skilled development workers and shortages of staff willing to work in distressed areas and the diversion of staff resources to non-lending activities such as counselling, education and the marketing of financial services to a traumatised and suspicious population (Nagarajan 2000:3, USAID 2001b). The destruction of roads, bank branch networks and telecommunications increases transaction costs.

Additional investment in security for program assets, staff and clients may be required. PCMFIs may find it necessary to incorporate additional emergency relief measures such as food donations, or additional social services such as primary health care and education. Such additions have the positive effects of increasing client goodwill, outreach and loyalty, but add considerably to program costs (Doyle 1998).

Moreover, demand for financial services is likely to be focused on less profitable products such as secure savings facilities and small, short-term loans for consumption and low-value IGAs. In the immediate conflict aftermath, households may exhibit a "post-war syndrome" characterised by low confidence, trust and motivation and reluctance to take on debt (Doyle 1998). As asset depletion and environmental instability increase the probability and the consequences of a loss, households are risk-averse, often stating a preference for reducing consumption or working for wages rather than taking loans (Wilson 2001). The microfinance products most in demand are protectional services such as savings facilities, small, short-term cash loans and in-kind loans, used primarily for consumption, house reconstruction and asset replacement (Wilson 2001, Williams et al 2001, Doyle 1998). Where there is demand for microenterprise credit, initial client preference is for low-risk, low-value, quick-return working capital investments with low entry and exit costs, although demand for larger, longer-term loans for fixed capital investments increases over time (Wilson 2001, Williams et al 2001). Demand for microfinance is higher in towns than in the countryside, probably in response to greater security, availability of cash, functioning markets and higher household incomes (Wilson 2001). Demand for savings services is generally high, although clients may be wary of depositing their savings in MFIs. The propensity to deposit savings with an MFI is strongly associated with the existence of trust between members and confidence in program integrity (Doyle 1998, Wilson 2001, Williams et al 2001).

Thus, in PCEs the traditional promotional objective of microfinance assumes relatively less importance while protectional and social capital building objectives receive a higher priority. This is of particular importance for the pursuit of commercialisation, as protectional and social intermediation activities do not generate the returns necessary to support commercial sustainability and require a form of subsidy, either directly from donors or by cross-subsidies from more profitable activities. Among the key success factors for FSS identified in the "best practices" literature are minimalist "core" financial services, interest rates and fees set at full cost-recovery levels, and low operating costs relative to portfolio size. There is great difficulty in adapting these program design features to protectional and social capital-building functions. As social mobilisation and community development activities do not generate direct financial returns, they would be supported by profit-maximising programs only to the extent that they are seen as essential to the efficient delivery of core financial services, and communities which require substantial investment in social capital building are likely to be avoided by such programs. Similarly, protectional strategies are unlikely to be profitable, as loans are typically small, involving relatively high transaction costs, and may not generate returns which enable the borrower to pay full cost-recovery based interest rates.

An overwhelmingly promotional focus is necessary, but not sufficient for FSS. The large unit transactions and streamlined service structures characteristic of FSS generally require a strong, sustainable microenterprise sector, which in turn depends on access to vigorous markets and reliable infrastructure, well-developed human capital in the form of entrepreneurial and vocational skills, and a stable economic, political and legal environment (Snodgrass 1996, Shaw 2004). Most FSS programs, such as BancoSol in Bolivia, target non-poor, urban microentrepreneurs. Others, such as the ASA in Bangladesh, target poorer borrowers with smaller microenterprises, relying on a streamlined cost structure, minimalist financial-services only approach and the economies of scale generated by great breadth of outreach (more than 8 million clients in the case of ASA) (MicroBanking Bulletin 2003). In PCEs, the profitability of promotional interventions is hampered by the low absorptive capacity of the microenterprise sector, with human capital depletion and severe disruption to markets and infrastructure. The capacity to expand breadth of outreach may be limited by security and demographic factors. There is often a high demand for non-financial business support services, with many new entrants to the informal sector, who need to learn new skills (Doyle 1998:25).

Nevertheless, many donors believe that post-conflict MFIs can and should achieve FSS, and build FSS into their design. World Bank-supported MFIs in the Bosnia Local Initiatives Project, for example, were required to become fully independent of subsidies after two years (Kuehnast 2001). Others favour a longer-term approach, recognising that PCMFIs may require extended timeframes for the achievement of FSS (USAID 2001b). While there is little data on the impacts of commercialisation on MFI operations in PCEs, there are indications that full cost recovery is problematic. A survey of 14 PCMFIs in six countries found that only three had achieved full OSS, two of which were located in urbanised middle-income European settings (Doyle 1998:48). Despite the growing number of PCMFIs established with a view to longer-term sustainability, few have attained full FSS (Nagarajan 1999 cited in Frasier and Saad 2003, Frasier and Saad 2003). Constraints on FSS include weak markets (found to be a more significant constraint in rural than in urban areas) (Frasier and Saad 2003), and small loan size (Doyle 1998). Commercialisation may have a negative impact on social capital formation, with a shift in emphasis towards cost-minimisation which may adversely impact social intermediation services. MFIs which concerned themselves with community and social development objectives in the immediate conflict aftermath may move towards more profitable commercial activities (Bateman 2003:63). MFIs in pursuit of FSS in Cambodia found that they needed to eliminate or reduce their non-financial services, and adopt broad-based targeting rather than focus on the most disadvantaged client groups (USAID 2001a)

4. Brief History of Bougainville and Conflict

PNG lies to the north east of Australia and is the largest nation in Micronesia. Bougainville is one of 19 provinces of PNG. It is located 500 kilometers east of the PNG mainland, and comprises one large island, 200 kilometres long and 40 kilometres wide, and a number of smaller islands. Its population is estimated at between 150,000 and 200,000[1]. Bougainville's culture is heterogeneous with 23 distinct languages are spoken (over 600 distinct languages are spoken across PNG as a whole - see Spriggs 1997). As a group, Bouganvillean culture is quite distinct to those found on the mainland. Indeed, Bougainville has much stronger cultural, ethnic and linguistic affinities to the Solomon Islands, which is separated by only a seven kilometre wide strait (IDEA 1999). A ten-year period of conflict centring on issues of independence occurred in the PNG province of Bougainville between 1988 to 1997.

The social, political, economic and environmental consequences of this conflict were severe. Whilst a formal peace settlement granting autonomy and a future referendum on independence was reached in 2001, the political and socio-economic environment is still dominated by the events of the past.

Bougainville was first inhabited over 28,000 years ago by various Austronesian and Polynesian groups. European traders first settled on Bougainville over 200 years ago. The Germans formerly annexed Bougainville in the latter half of the nineteenth century at the same time they colonialised the Solomon Islands and what is now the northern part of PNG (known then as New Guinea). Shortly after however, the Germans ceded the Solomon Islands to the British, but maintained control of Bougainville and New Guinea. Following World War One, Australia began administering New Guinea (of which Bougainville was part) under the auspices of the League of Nations. During World War Two, the Japanese controlled Bougainville, before it again become administered as part of New Guinea by Australia under the auspices of the United Nations at the cessation of hostilities. When Papua New Guinea achieved independence in 1975, Bougainville formed part of this new nation despite some Bougainvilleans seeking independence at this time (Griffen 1982; May and Regan 1997).

While under Australia's administration in the 1960s, copper was discovered in Bougainville's south eastern mountains. An open cut mine (called Pangana), measuring six kilometres by four kilometres was dug, affecting tens of thousands of hectares, destroying villages, displacing people and causing significant environmental damage and social disintegration (Ogan 1999). The mine was predominately owned by an Australian company, Rio Tinto, and was the world's largest copper mine at that time. Whilst the profits from this mine were significant, royalties to Bougainvilleans were insignificant, with the majority flowing to Rio Tinto and then, much later, an increased share (but still limited to 20 per cent) going directly to the PNG government. Bougainville itself never received more than $10,000 per million dollars of profits (compared to the central PNG government receiving $200,000 per million dollars of profit). At this time, the Pangana mine was the largest contributor to PNGs GDP (Regan 2002c). While some benefits from the mining included employment and some community development programs, the environmental exploitation and degradation caused by the mine over a twenty-year period was perceived by many Bougainvilleans to far outweigh these benefits.

The conflict in Bougainville formally started in 1988. Its causes were complex and numerous (Regan 1999b). Initially it began as a localised conflict in reaction to the on-going negative consequences of foreign-owned mining in Bougainville, but quickly transformed to a re-ignited independence movement directly linked to Bougainville's colonial history (Ogan 1999). In 1988, following almost 12 months of relatively peaceful demonstrations some local men, led by Francis Ona, blew up a power generator. These initial protests were against general lack of consultation with local people by the mine's operators, the distribution of wealth from the mine's profits, the influx on people from other parts of PNG and the environmental damage from the mine (Howley 2002; Spriggs and Denoon 1992). PNG relied heavily on the royalties from this mine (second only to foreign aid as its primary source of income) and its response to this relatively low-level act of industrial sabotage was severe (Ogan 1999; Amnesty International 1994). The PNG army and police reacted swiftly and harshly against perceived supporters of Ona. Ona took advantage of this harsh response to galvanise his support and turned this localized protest into a wider uprising centred on long-held claims for independence[2]. Ona formed the Bougainville Revolutionary Army (BRA) and declared independence and the formation of the Bougainville Interim Government (BIG).

Despite a number of peace initiatives, the conflict continued through the 1990s. This resulted in: 1) the death of 15,000 -20,000 people (overwhelming Bougainvilleans)– up to 10 percent of the total population; 2) the closure of the mine in 1989; 3) schools, hospitals and other government infrastructure being destroyed, resulting in a generation of young people having no formal education or health care and experiencing life in a state of lawlessness and violence; 4) crops being destroyed; and 5) many people being forced to live in inhospitable conditions in the mountains, surviving on traditional farming techniques.

Conflict between Bougainvilleans also occurred. Despite Ona's declaration of independence, not all Bougainvilleans were in favour of this position. Intra-Bougainvillean conflict was often more violent than the conflict between Bougainvillean and PNG forces. Numerous fighting forces were formed in addition to the BRA, including the Resistance, Home Guard and the Buka Liberation Force (BLF). At times, sub-units of the BRA under the command of village leaders would fight against other BRA units and support the PNG forces. During this time, traditional land disputes, ethnic rivalries and other grievances between Bougainvilleans resulted in fighting and often overshadowed the larger issue of independence in terms of motivation for violence (Howley 2002; Regan 1999a, 2002a; Ogan 1999). This intra-conflict complicated the negotiation of a peace agreement.

Finally though, the resources of both the local people and the PNG government were drained by the conflict. In 1997, the PNG government sought to hire mercenaries (through the company Sandline) to resolve the conflict before being forced to back down by domestic and international pressure. This incident gave impetus to find a solution and through 1997 and 1998, a peace initiative was brokered by New Zealand, involving a Truce Monitoring Group (comprising personnel from New Zealand, Vanuatu, Fiji and Australia). The peace process was a protracted exercise taking nearly five years to complete. Substantial negotiations centred on not only the peace outcomes, but also on the processes required to reach these outcomes (Regan 2002a).

The final negotiated peace settlement (signed on 30 August 2001) allowed for a autonomous Bougainville government and the opportunity to vote on full independence within a 10-15 ear timeframe. This outcome represented a compromise for both sides (Bougainville was seeking full independence, whilst PNG opposed any move towards secession). The interim autonomy granted to Bougainville is quite wide ranging. The Bougainville government may chose its own government structures, has wide foreign affairs powers, the ability to establish is own judiciary, prisons, police and public service, taxation powers and freedom from control of the national PNG government (Regan 2002b).

Scope for major economic development in Bougainville is limited. A functioning, export orientated agriculture sector does not exist with most recent efforts in agricultural rehabilitation being focused on small land-holders. While fishing and tourism may become increasingly important in the future, they are not viable at the moment. That leaves mining. The almost complete reliance on the Pangana mine to underpin all economic activity on Bougainville meant that following Pangana's closure in 1989, nearly all economic activity other than subsistence farming ceased. Not only were 10,000 direct jobs lost, but all the indirect and associated industries closed almost immediately (Regan 2002c). Without re-opening the mine, the economy of Bougainville cannot be the same as before the conflict. An economy based on mining is much different to an economy based on copra and coca, and to a limited degree, fishing and tourism (Regan 1999b). Re-opening the mine is a sensitive issue and not openly canvassed (Regan 2002a). Even if the new autonomous Bougainville government did decide to re-open the mine, it is unsure whether it could attract investment due to the previous conflict and the on-going self-imposed exclusion of Ona and his (albeit reducing) supporters.

The present autonomous government is currently faced with severe fiscal constraints. Due to the low levels of economic activity, the Bougainville government is still reliant on grants from the national government. 'All national taxation collected in Bougainville will be quarantined, with the proceeds of all, save custom duties (expected to be phased out according to WTO proposals over ht e next 1-15 years), company tax and 70 per cent of Value Added Tax (VAT) being paid to the autonomous Bougainville government. Revenue from the three taxes mentioned will be allocated towards meeting costs to the national government of the main grant payable to Bougainville (the recurrent grant). Fiscal self-reliance will be reached when receipts from the three taxes is sustainable greater than the total of the grant' (Regan 2002a, p. 8-9). There is therefore a heavy reliance on international donors and aid leading to a level of dependency (Regan 2002c, Regan 1999b). Such dependency must be overcome before Bougainville can consider full independence.

5. The BMFS

The idea for the BMFS was conceived by the Bougainville Transitional Government in 1996, as a means of contributing to the revival of Bougainville's social and economic structure. Despite its origins in the state sector, the concept of grassroots ownership was built into the project from its inception, with extensive community consultation and participation in the design process. An initial workshop was held in 1996 for members of the Bougainviile bureaucracy and community "opinion leaders", followed by a series of workshops held during 1997 and 1998, attended by people from all districts of Bougainville. The mission statement which emerged from these workshops affirmed community ownership of the project and emphasised a gradual, grassroots-led development process. These workshops also agreed on a structure for the BMFS which involved a loose federation of grassroots microfinance institutions (GMFIs) located throughout Bougainville, coordinated and supported by a central peak body, the Bougainville Haus Moni (BHM).

From 1999 to 2004 the BMFS received funding from AusAID, with counterpart funds from the Bougainville government. An Australian development agency, AVI, was appointed by AusAID to manage the project. AusAID support has focused on building the institutional capacity of the BHM and to a lesser extent, the GMFIs. AusAID support is premised on the institutionist model which envisages temporary donor support as a stepping stone to longer-term FSS. While recognising a need for training and other non-financial microenterprise support services, it favours a minimalist approach, arguing that the BMFS should focus on financial services, contracting out non-financial BDS activities to other agencies (AusAID 2001). With the termination of the current phase of AusAID support at the end of 2004, it is proposed that the BMFS will move into a new phase in which further emphasis is placed on commercialisation.

The BMFS is a three-tiered structure consisting of the GMFIs, three mid-level BHM district offices, and the BHM headquarters located in Buka. The BHM Board of Management is composed of government representatives and community representative elected by GMFI members. The BHM provides management training and awareness-raising services to existing and prospective GMFIs. It also has responsibility for development of standardised policies and procedures, although progress in this area has been slow, and there is little standardisation of practices at GMFI level – discussed below. To date the project has not involved the provision of seed funds to GMFIs: all capital is raised by the GMFIs themselves through savings mobilisation.

Since its establishment in 1996, the BMFS has significantly expanded its outreach to become Bougainville's leading microfinance identity. The number of GMFIs has grown from 42 to 332 over the same period, and outreach has grown from 6,000 to more than 16,000 over the same period – a coverage of more than 5 per cent of the population. GMFIs establish their own membership criteria. Most GMFIs are village-level clan-based organisations, while others are women's groups and church-based groups. In recent years there has been a growth in larger, urban GMFIs in the Buka area, with a predominantly small business client base. The average size of GMFIs is just below 50.

Key issues and challenges in the future development of the BMFS are outlined below.

Client demand

Although AusAID emphasises income promotion over protectional and social capital-building functions, members see the program primarily as a tool for re-building social capital, providing savings facilities and small loans, primarily for non-enterprise and protectional purposes such as school fees, customary obligations, and consumption-smoothing during lean seasons. Most have indicated strongly that their preference is for savings rather than loans, although some in the larger, urban GMFIs have indicated a preference for larger loans for microenterprises. There are indications that the GMFIs have had some success in rebuilding social capital, with some GMFIs engaging in community projects such as the restoration of church buildings, and establishing small-scale cooperative community ventures in animal husbandry. Expatriate aid workers report instances where GMFI participation has led to the re-establishment of relations between previously estranged families.

Institutional performance

To date the GMFIs have received no external seed funds, and rely entirely on the mobilisation of members' savings for their small lending programs. While savings mobilisation has so far proved sufficient to meet members' limited demand for loans, it is unlikely to support any increase in demand for credit. Financial performance at

GMFI level appears weak, with limited financial and management skills and little standardisation of practices. Interest rates on savings deposits and loans are determined by GMFIs, apparently with little regard for institutional viability, a problem compounded by inflation, which is estimated at 9.8 per cent. There is a clear need for substantial further investment in the building of GMFI institutional capacity. Any scaling up is likely to require an injection of capital, a problematic issue given a generally unfavourable credit culture where external funds are concerned. Furthermore, without clear evidence of demand for increased credit, there is a risk of creating a supply-driven credit culture which has little regard for the needs of participants and may threaten the strong stakeholder ownership that is currently a major strength of the program.

Weak credit discipline and distrust of financial institutions
Financial sector development in Bougainville has a chequered history. The formal financial sector is severely underdeveloped. The only formal bank in Bougainville is a sub-branch of the PNG Banking Corporation, located in Buka, which is inaccessible to most Bougainvilleans as travel to Buka is prohibitively expensive and time-consuming. Savings and loans societies, a form of credit union cooperative, were introduced into PNG in the 1960s and were widely used in rural areas. Most of them collapsed in the 1980s, following large-scale loan defaults related to falling commodity prices in the early 1980s, compounded by generally poor and in some cases fraudulent institutional management. S&Ls in Bougainville lasted into the 1990s, partly supported by earnings from the Panguna mine, but fell into difficulties with the civil conflict and mine closure 1989. By 1998 all of them had failed, taking the bulk of members' deposits with them (AusAID 2001:12). The increased lawlessness during the time of conflict resulted in people burying large sums of money to safeguard their wealth. It is estimated that up to 20 million kina may be buried as people sought to protect their wealth during the conflict.

Microfinance initiatives have also been problematic. The main alternative to the BMFS in recent years has been a credit scheme sponsored by the EU in collaboration with the Bougainville Provincial Council of Women, which is generally agreed to have been a failure: there is little evidence that it contributed significantly to microenterprise development, and of the K500,000 loan capital allocated by the EU, only K8,500 had been repaid. Among the main factors in poor performance were weak management capacity, the failure of the solidarity group system and an unfavourable credit culture, in which loans from outside sources were widely viewed as grants (AusAID 2001). Other international NGOs have established very small-scale, subsidy-dependent microfinance programs which function as adjuncts to other community development interventions. The promotion of microfinance was further set back by a series of pyramid money schemes which emerged in the late 1990s, leading many households to withdraw their savings from existing financial institutions and deposit them in the pyramid schemes (Regan 2002c). The subsequent failure of these schemes has decapitalised MFIs and contributed to a loss of confidence in legitimate microfinance agencies. 'U-Vistract, Money Link, Millennium and Nekong are four pyramid schemes initiated by Bougainvilleans and run in Bougainville and other parts of PNG… they took millions of kina out of Bougainville (informed opinion has it they took 2 million kina out of Arawa in two days)' (Howley 2002, p. 66).

Weak social capital
Prior to 1989, over 10,000 Bougainvilleans were employed directly by the mine. Whilst low by international standards, the salaries and wages of these employees were very high by Bougainvillean standards. A serious consequence of this influx of wealth was the challenge to traditional power structures and community spirit. Young men were able to gain great influence in their home villages by buying gifts and sharing their wages, challenging the traditional relationships based on community services that favoured village elders. 'In traditional Bougainville society, when a clash occurred between the rights of the individual and the security of the community, the community rights were paramount. The breakdown of society, which had begun with colonial control, was accelerated with the arrival of the mining company. Young men placed their individual rights first and a culture of exaggerated individual rights, individual interpretation of traditional values, and materialism became the new order' (Howley 2002, p. 31). The conflict exacerbated this breakdown by placing greater pressure on traditional power structures and this has not been resolved in this post-conflict environment.

Trauma is a serious social problem in Bougainville. Many people were traumatized by the violence directly afflicted upon them, but also by what they had seen and by what they did to others (Howley 2002). No families or villages were left unaffected. In post-conflict situations women are also at high risk due to the low levels of trust and security in society and the increase in violence directed against them (Tonissen 2000; Regan 1999b). Levels of social cohesion and trust are presently low. Intra-group conflict has a long history (pre-dating colonialism) in Bougainville (Regan 1999b), but the recent period of conflict has exacerbated this situation. Despite a weapons disposal plan being part of the peace agreement, the de-commissioning has not been entirely effective (Regan 2002a). The result is still a heavily armed population with a recent history of reverting to violence to resolve disputes. Violence and outbursts of lawlessness using guns, continues to be a social problem (Howley 2002; Regan 1999b). Reconcilation and the building of trust and cooperation are central community developmet priorities.

Microenterprise development
Livelihood patterns have been disrupted by capital flight and the collapse of the formal sector with the closure of the mine. Alternative wage employment opportunities are extremely scarce. Plantation agriculture, a potential source of jobs and export earnings, remains underdeveloped, although there are promising initiatives, and there is little prospect of a resumption of mining in the near future. In the medium term at least, most households will remain reliant on informal sector livelihoods in the form of smallscale agriculture and non-farm microenterprises.

However, microenterprise-based income generation faces significant constraints. Household asset bases including housing, land, livestock, tools and savings have been partially or completely destroyed. Physical infrastructure has been severely affected by combat damage. All significant roads were destroyed during the crisis, and the reconstruction program, funded by the EU and AusAID, has been slow. Human capital has been depleted by war casualties, psychological trauma, the loss of health services, lapses in formal education and emigration. Education services in most areas of Bougainville were almost completely shut-down after 1988. As a result, an entire generation of young Bougainvilleans are illiterate and without basic education. Health services also closed down resulting in many unnecessary deaths and preventable illness leading to complications and chronic poor health. (Howley 2002). Markets have been disrupted by population displacement, heightened poverty and the destruction of transport links. Ongoing intra-community tensions and weak law enforcement are disincentives to microenterprise investment. An influx of entrants to the informal sector may create problems of over-supply and market saturation. With high poverty incidence, the scope and scale of microenterprise opportunities is reduced, as demand tends to be limited to essentials.

Future Strengths

Future MFIs in Bougainville will need to protect, nurture and build upon a small number of positive outcomes that occurred during the conflict period in order to development successfully in this PCE. In response to the blockade placed around Bougainville, local ingenuity led to mini-hydroelectricity systems to power remote villages, engines were modified to run on coconut oil, and there was a return to traditional medicines and diet (Regan 1999b). This self-reliance provides a strong basis for future development, but one that must be carefully managed along with the high expectations that flow from obtaining autonomy. Further, community development must emphasise the important role women play in Bougainville society. Women played a central role in initiating the peace process in 1997 through their mediation with all sides, particularly those involved with the warring intra-Bougainvillean conflict (Saovanna-Spriggs 2000; Howley 2002; Hakena 2000). This must not be lost in post-conflict development interventions.

Indeed, some post-conflict development is slowly beginning. Most internally deisplaced people have returned to their villages, and many of the 10-13,000 refugees who departed to other parts of PNG or the Solomon Islands are also returning. The roads that were destroyed are slowly being remade and freedom of movement (in most areas) is now being restored. Small holder cocoa producers will soon undertake their first harvest since the mass planting of over 4 million cocoa seedlings (funded by AusAID/UNDP) following the truce in 1997. There is also increased cooperation between previously opposing government institutions – namely the Bougainville Interim Government (BIG), local council of chiefs, Bougainville Transitional Government, council of elders and BRA (Regan 2002a, 2002c).

Limited size of microfinance market

Given Bougainville's small population and the already extensive coverage achieved by the BMFS, there is little scope for further scaling up. The economies of scale generated by the impressive breadth of outreach of the major Asian MFIs such as the ASA, which number their clients in the millions, are not available to the BMFS.

6. Conclusion

Following ten years of civil conflict, Bougainville urgently requires social and economic development interventions to build capacity of local communities, increase trust between communities, build assets and infrastructure at the local level. There is now a high level of expectation from ordinary Bougainvilleans regarding the future of an independent Bougainville. Dealing with these expectation in a post-conflict situation will place great strain on the newly formed government. 'Not only are there massive social problems to deal with arising from the impacts of the conflict, but the economy is weak. As a result, not only are opportunities for economic advancement for Bougainvilleans (including ex-combatant and young men with scanty education) limited, but the revenue base for the government can also be expected to be poor for a long time to come, something that will limit the ability of the government to develop its capacity and programs' (Regan 2002a, p. 13). Future development in this post-conflict period will need to be undertaken with caution and care to ensure that the social and economic constraints faced by Bougainville are fully considered and incorporated into development analysis.

Microfinance should form part of such analysis. A non-commercial microfinance scheme, the BMFS, is currently operating successfully in Bougainville. However, as it undergoes commercialisation, it will face a range of complicated issues. The future development of the program will have to take account of a number of challenges. In Bougainville, as in other PCEs, commercialisation faces particular obstacles in the forms of additional costs imposed by the program environment, and the prioritisation of protectional and community development objectives. Demand for promotional microfinance is weak, and there are significant constraints on microenterprise development. There is a need for substantial investment in capacity-building, training and social mobilisation, given management weaknesses at the GMFI level, a problematic credit culture (especially where foreign-sourced seed funds are concerned), and weak social capital development. Future managers should also protect and build on the program's substantial strengths, notably the high level of goodwill, commitment and stakeholder "ownership" which extends from the highest levels of the Bougainville government to the grassroots, and the determination of Bougainvilleans to create a self-reliant nation. Future research is required to analyse the appropriateness of large-scale commercial MFIs in PCEs and to identify best practices which promote the goals of institutional sustainability, client outreach and impact, and minimise potential trade-offs between them. The risk of negative outcomes is real, but all business is PCEs in risky business.

Footnotes

1. Reliable economic, demographic and social data for Bougainville does not exist. Since the beginning of the conflict in the late 1980s, functioning government services, including data collection, have been suspended. The last census taken in Bougainville was in 1980. Such services have not commenced in a meaningful way despite the Peace Agreement being finalised in 2001.
2. Bougainville did actually declare independence on 1 September 1975, but soon withdrew this declaration following various concessions from the PNG national Government (Howley 2002).

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