Schweizerische Friedensstiftung
Fondation suisse pour la paix
Fondazione svizzera per la pace
Swiss Peace Foundation

Working Paper

swisspeace

3 | 2008

"Financial Peacebuilding" - Impacts of the Nepalese conflict on the financial sector and its potential for peacebuilding

Ulrike Joras

swisspeace

swisspeace is an action-oriented peace research institute with headquarters in Bern, Switzerland. It aims to prevent the outbreak of violent conflicts and to enable sustainable conflict transformation.

swisspeace sees itself as a center of excellence and an information platform in the areas of conflict analysis and peacebuilding. We conduct research on the causes of war and violent conflict, develop tools for early recognition of tensions, and formulate conflict mitigation and peacebuilding strategies. swisspeace contributes to information exchange and networking on current issues of peace and security policy through its analyses and reports as well as meetings and conferences.

swisspeace was founded in 1988 as the "Swiss Peace Foundation" with the goal of promoting independent peace research in Switzerland. Today swisspeace engages about 30 staff members. Its most important clients include the Swiss Federal Department of Foreign Affairs (DFA) and the Swiss National Science Foundation. Its activities are further assisted by contributions from its Support Association. The supreme swisspeace body is the Foundation Council, which is comprised of representatives from politics, science, and the government.

Working Papers
In its working paper series, swisspeace publishes reports by staff members and international experts, covering recent issues of peace research and peacebuilding. Please note our publication list at the end of this paper or on www.swisspeace.org.

The views expressed in this publication are those of the author(s) and do not necessarily reflect the views of swisspeace.

Publisher: swisspeace
Design: Leib&Gut, Visuelle Gestaltung, Bern
Print: CopyQuick Printing Center, Bern
Copies: 300
swisspeace, Sonnenbergstrasse 17,
PO Box, 3000 Bern 7, Switzerland
www.swisspeace.org
info@swisspeace.ch

ISBN 978-3-908230-73-1

Working Paper 3 | 2008

"Financial Peacebuilding"- Impacts of the Nepalese conflict on the financial sector and its potential for peacebuilding

Ulrike Joras

November 2008

About the Author

Dr. Ulrike Joras is project coordinator for Business & Peace at swisspeace. She holds a PhD in Economic Geography from the University of Aachen (Germany) and works on different subjects related to the role of the private sector in conflict settings and peace processes.

Acknowledgments

The author would like to thank the Swiss Development Cooperation for its generous funding for this project.

The project would not have been possible without the support of Sanjay Jah, Chhaya Jha, Sascha Müller, Bishnu Upreti, and the SDC office in Nepal, primarily Mr. Pramesh Shrestha.

I am particularly grateful for very helpful comments to an earlier version of this study by John Bray, Laurent Goetschel, Marc Probst, Sascha Müller, Marcel von Arx, as well as Rina Alluri, who also took care of the language editing.

A particular warm thank you should go to all those interview partners who dedicated their time, thoughts, and ideas.

Supported by the Swiss Academy
of Humanities and Social Sciences
www.sagw.ch

Table of Contents

Acronyms

ADB	Asian Development Bank
CPA	Comprehensive Peace Agreement
CPN (M)	Communist Party of Nepal (Maoist)
CSR	Corporate Social Responsibility
MFI	Micro-Finance Institution
MIGA	Multilateral Investment Guarantee Agency
IDP	Internally Displaced Person
RRDB	Regional Rural Development Banks
SAARC	South Asian Association for Regional Cooperation
SFCL	Small-Farmer Cooperatives Limited

List of graphs

Abstract/Zusammenfassung/Résumé

The financial sector is assumed to have a catalyst role for economic development. The provision of financial services, such as banking services, can directly contribute to poverty reduction and economic growth. It enables people to better manage their risks and facilitates investments. The importance of an adequate financial service provision has also been recognised for post-conflict peacebuilding and reconstruction. So far, research undertaken in this field has mostly explored the role of microfinance institutions in post-conflict peacebuilding and the structural pre-conditions necessary for the recovery of a depleted financial sector. Little attention has been paid to the role of (local) private commercial banks in peacebuilding – particularly in those countries where the financial infrastructure was affected by a conflict but remained functional. This working paper looks at options of how the local financial sector may contribute to post-conflict peacebuilding, taking the specific example of Nepal. It differentiates between private commercial banks, governmental commercial banks and microfinance institutions and explores how these institutions were affected by the violent conflict in Nepal, how they responded to challenges, and discusses options as well as limitations for financial sector engagement in peacebuidling.

Il est communément admis que le secteur financier occupe un rôle central dans le développement économique. La fourniture de services financiers, comme les services bancaires, peut directement contribuer à réduire la pauvreté et à favoriser la croissance économique. Cela permet aux populations de mieux gérer les risques et de faciliter l'investissement. L'importance d'un système financier adéquat a aussi été reconnue dans le cadre des opérations de consolidation de la paix et de reconstruction après les conflits. Jusqu'à maintenant, les recherches conduites sur ce sujet se sont surtout concentrées sur le rôle de la microfinance dans les situations de consolidation de la paix et sur les conditions nécessaires au développement du secteur financier dans des pays où le secteur financier a été réduit presque à néant par un conflit. Peu d'attention a été accordée au rôle des banques (locales) commerciales privées dans la consolidation de la paix dans les pays où l'infrastructure financière a été affectée par un conflit mais est restée fonctionnelle. Cette recherche s'intéresse aux différentes options rencontrées par le secteur financier à propos de son éventuelle contribution à la consolidation de la paix, en s'appuyant sur le cas du Népal. Il est fait la différence entre les banques commerciales privées, les banques commerciales publiques, et les institutions de microfinance; la manière dont ces institutions ont été affectées par le conflit violent au Népal et comment les acteurs ont fait face aux différents défis sont des points directement abordés, tout comme il est discuté les options qui s'offrent au secteur financier pour la consolidation de la paix et les limitations inhérentes à un tel engagement.

Der Finanzsektor hat eine Katalysatorfunktion für wirtschaftliche Entwicklung. Finanzielle Infrastruktur kann direkt zu Armutsreduktion und wirtschaftlichem Wachstum beitragen. Sie ermöglicht es der Bevölkerung, Risiken besser zu managen und Investitionen zu realisieren. Die Bedeutung von finanzieller Infrastruktur ist auch für Wiederaufbau und Friedensförderung erkannt worden. Bislang hat sich die Forschung in diesem Gebiet hauptsächlich mit Mikrofinanzinstitutionen auseinandergesetzt, sowie mit den notwendigen strukturellen Rahmenbedingungen für den Wiederaufbau von zerstörter finanzieller Infrastruktur. Kaum betrachtet wurde hingegen, welche Rolle der (lokale) private, kommerzielle Finanzsektor für Wiederaufbau und Friedensförderung spielen kann - insbesondere in Ländern, in denen der Finanzsektor zwar von einem gewaltsamen Konflikt betroffen, aber noch funktionstüchtig ist. Dieses Working Paper beschäftigt sich mit möglichen Beiträgen des lokalen Finanzsektors zum Wiederaufbau in Nepal. In der Studie werden private kommerzielle Banken, staatliche kommerzielle Banken und Mikrofinanzinstitutionen unterschieden. Es wird dargelegt, wie die verschiedenen Institutionen durch den Konflikt in Nepal beeinträchtigt wurden; welche Massnahmen ergriffen wurden, um mit den negativen Effekten des Konflikts umzugehen; und was die Möglichkeiten und Grenzen eines Beitrags des Finanzsektors zur Friedensförderung sein könnten.

Background

1 Introduction

This report looks at options of how the local financial sector may contribute to peacebuilding in countries coming out of violent conflict, taking the specific example of Nepal. Given the importance of a functioning financial infrastructure for economic development, the (possible) role of financial actors in peacebuilding has been raised by a number of authors. Yet, a more detailed study on the potentials and challenges for (local) financial sector engagement in sustainable peacebuilding has not yet been undertaken.

The discussion on the role of the financial sector in peacebuilding is embedded in broader debates on corporate social responsibility (CSR) and financial sector entanglement in violent conflicts. Awareness and knowledge has successively increased over the last years on how financial actors are linked to environmental issues, human rights concerns as well as the emergence or facilitation of conflicts. The international financial system has been found to transfer funds to and from a number of violent hotspots in the world, fuelling the continuation of civil wars (Winer 2002). Although the sector is becoming more and more responsive to the increasing CSR trend, the specific potentials of financial institutions in assisting in peace processes are still a relatively niche topic. The UNEP Finance Initiative (UNEP FI) report on the role of the financial sector in contributing and easing violent conflicts concluded that financial institutions have to be integrated into efforts to prevent conflicts and support post-conflict reconstruction. However, the report also acknowledged that "the international community has often called for engagement with the private sector in conflict prevention and post-conflict reconstruction, yet currently lacks the appropriate framework for doing so in the case of the financial sector. Very little useful information has emerged to guide financial firms towards engagement in post-conflict reconstruction, and towards encouraging better management - if not prevention - of conflict issues by those in whom they invest. Moreover, firms are without guidance on appropriate behaviour in instances where the context, in which their investment has taken place, changes from peace to conflict or oppression" (Bray et al. 2004: 2).

It is for this reason that this study aims to add to a better understanding on how the financial sector may contribute to effective conflict management. Far from offering an "appropriate framework", as was requested in the UNEP FI report, this study seeks to discuss, using a concrete case, the options as well as limitations for financial sector engagement in peacebuidling. It explores how the financial sector in Nepal was affected by the violent conflict between the Maoists and the government (1996-2006), how it responded to challenges and how the sector may contribute to peacebuilding.

The report looks specifically at local financial institutions. Research on post-conflict financial sector development so far has mostly focused on international financial sector actors, microfinance institutions, informal institutions such as the *hawala* system, and formal prerequisites, which are considered necessary for the reconstruction of a financial system. Little attention has been paid to local formal financial actors. The study looks specifically at private commercial banks but also addresses, in order to get a more comprehensive picture, state commercial banks and microfinance institutions and their relevance for post-conflict peacebuilding in Nepal. Local private commercial banks are understood as banks, which are 100 per cent in Nepalese ownership as well as joint-venture banks, which are partly held by Nepalis and partly by foreigners. The main reason for also including joint-venture banks into the research is their importance for Nepal where 100 per cent foreign ownership of banks is not permitted.

The motivation for choosing Nepal as the case study for this topic was two-fold: Firstly, because at the time when the research began, Nepal was at an early phase of its peace-process, allowing focusing on the period where local financial institutions may have a particular role to play (see below). Secondly, it was known from the literature review that the Nepalese violent conflict negatively affected parts of the financial sector in the country, but did not lead to a full collapse of the financial infrastructure. A still partly functioning financial sector was a precondition to explore the main research question of this report: the local financial sector's role in peacebuilding.

Qualitative methods were chosen for the research. The report is based on about 40 semi-structured interviews, most of them conducted in Nepal and some background interviews held in Switzerland. In Nepal, 32 interviews were held in Kathmandu and five in a district capital in the South of the country. The following groups of interviewees were consulted during the research in Nepal: National and international NGO representatives and researchers (8); representatives from the finance sector and other business representatives (19); governmental representatives (2); and representatives from international organisations (8). The research further benefited from a series of workshops that swisspeace realized in 2005 on financial sector contributions to transforming economies of violence.

The study is structured into two main parts: Part one discusses the general literature on the subject, positioning the main research question within the overall debate on corporate engagement in conflict management and the debate on financial institutions and CSR (chapter 2). The second part of the study deals with the Nepal case study. Chapters three and four provide information on Nepal, its economic structure, financial sector landscape and conflict. Chapter five discusses the economic impacts of the conflict on the national economy in general and the financial sector in particular. Chapters six and seven bring the previously provided information together by analysing and discussing the potential and limits of financial sector contribution to peacebuilding in Nepal. The quick reader with a background in corporate engagement in peace promotion and / or Nepal may want to focus exclusively on chapters six and seven.

2 The financial sector in peacebuilding

The main purpose of this chapter is to set the stage for the case study on Nepal, dealt with in the second part of this report. The following paragraphs provide background information on the issue of financial actors in peacebuilding; discuss the focus of the study on the local banking sector and contextualise the subject in the broader debates on corporate engagement in conflict and conflict management.[1]

2.1 The financial sector in zones of violent conflicts

Operating in a conflict context has typically two sides for a company: One is how the company is affected by the violence; the other one is how the company itself may contribute to facilitating or enhancing the violence. The financial sector has mostly been in the news in the last years with regard to the latter. It is primarily through money transfers, provision of deposit services, and commercial borrowing to conflict parties that financial institutions knowingly or unknowingly facilitate sustained violence (Duffield 2000; Addison 2002; Winer 2002; Mansley 2005). To illustrate the links between the international financial system and conflict funding, Taylor wrote in an abridged way: "The lifeblood of some armed conflicts is the revenue generated by natural resources or illicit trade. Illicit financial services are the arteries that transmit and deploy those revenues. Put in the simplest of terms, illicit finance is what makes it possible for money from the sale of conflict goods to buy small arms to be used in war" (Taylor 2002: 5). Financial resources are vital for conflicting parties - government forces as well as rebel groups - to enter and stay in war. In some conflicts, remittances transferred by diaspora groups have helped to fund war. In others, it is the selling of natural resources by rebels or state officials that financed warfare. In either case, funds are moved through the international finance system - through legal or illegal ways - from abroad into the conflict country and from the conflict country to accounts abroad. A number of protracted conflicts worldwide, such as in Afghanistan, Angola, Colombia, Liberia or Sierra Leone have in this way been associated to the international finance system.

But although a range of **financial regulatory regimes** have emerged in the last years addressing transactions of proceeds stemming from illegal businesses, none of these regimes directly tackles transactions of profits made through the trade of "conflict commodities", such as diamonds, oil, timber or coltan (Winer 2005) (Winer 2002; Winer 2005). The Financial Action Task Force on Money Laundering (FATF), for instance, was established in 1989 with the original motivation to contribute in the fight against drugs and organised crime. Although the scope of FATF's work was successively revised, FTAF does not address commodities often used to fund war (Kremer 2004). Also other initiatives, such as the UN Convention against Transnational Organized Crime, the six UN Principles for Responsible Investment, or initiatives by the financial sector itself, including the transparency

[1] The term "financial sector" can be understood in many different ways given the highly diverse nature of this sector. For some, the term may include commercial banks, insurance or asset managers; others may also include microfinance institutions and development banks and again others may argue that the term should also comprise central banks and financial regulatory bodies. For the purpose of this study, the term "financial sector" will be used broadly, including private and governmental financial institutions, such as banks, insurance development-banks, microfinance institutions etc. Financial institutions are understood as agents that provide different financial services for their clients and members. Banks are understood here as financial institutions that act as a payment agent for customers, and borrow and lend money. The terms private banks and governmental banks are here used to differentiate between the ownerhsip of the banks. "Private banks" are not understood as banks that manage the assets of wealthy individuals, but as banks in private ownership. Also the term "commercial bank" is here understood in order to differentiate it from development banks that provide financial services and credit to underserved markets and populations. Commerical banks are not understood as a bank that only deals with deposits and loans from corporations or large businesses.

standards developed by the Wolfsberg Group tackle money laundering, terrorist financing, transparency or corruption through "due diligence" and "know-your-customer" policies, but not specific problems related to the financing of conflicts.[2]

This is also to some extent true for the frequently cited **Equator Principles**. The Equator Principles (EP) were established in 2003 by a group of international private sector banks as a non-binding set of guidelines, seeking to improve the social and environmental performance of project-funded transaction.[3] The signatories are supposed to only provide loans to projects that can prove sound social and environmental construction and operation practices.[4] The principles attracted much attention from activists and scholars in the field of peace and security studies, given the frequent association of project-funded investments with violent conflicts. Project funding is commonly used for large infrastructure projects as well as mines, pipelines, or dams, often in developing countries or emerging markets where political perils are high. Due to factors, such as the large size of the investments, their social and environmental intrusion on local communities, or the related large inflow of revenues on the national level, these projects are prone to ignite or contribute to conflicts. By providing money to these investments, financial institutions may indirectly trigger or exacerbate violence. Many of the aspects covered by the EPs (such as environmental issues) are of importance also from a conflict-perspective, but explicit references to conflict contexts are mostly absent in the principles. Only in the "illustrative list of potential social and environmental issues to be addressed in the social and environmental assessment documentation" are the "protection of human rights and community health, safety and security" mentioned, with references primarily made to the hiring of security personnel. Although, the Equator Principles improved financial institutions' social and environmental standards (for instance Banktrack 2003; Banktrack 2006; EIRIS 2006), the sparse mentioning of conflict issues, is a major shortcoming. This highlights the weaknesses of financial sector responses to the issue of violent conflict for one specific funding instrument (Crossin/Banfield 2006).

In fact, in comparison to many other economic sectors, the **financial sector** is relatively late in responding to the **corporate social responsibility** (CSR) trend in general. According to some NGO-reports, banks still "lag significantly behind relevant international standards and best practices", revealing the challenges that still lay ahead (see for instance The Corporate Responsibility Coalition 2005; WWF/Banktrack 2005). The rising awareness in the aftermath of 9/11 on the role of financial institutions in facilitating the funding of terrorist attacks seemed to have triggered a startling momentum. Pressure from regulators tightened, demanding a more careful monitoring of financial transactions; voluntary initiatives on transparency and corporate accountability surfaced; social and environmental management systems developed; a plethora of publications, workshops and conferences realized. The Financial Times wrote, for instance, that between 2004 and 2007, the spending of banks in anti-money laundering activities increased by over 50 per cent (Croft 2007), but more has still to be done that goes beyond due-diligence and Know-Your-Customer policies to adequately address corporate entanglement in violent conflicts.

2 Interesting in this context is also the Abacha Commission, where in collaboration with banks some first steps were made to repatriate funds stolen by potentates (see for instance Daniel 2004; Scher 2005).

3 Project finance is a specific funding instrument in which lenders are repaid through the revenues that are generated by the project, once in operation (Crossin/Banfield 2006).

4 The EPs are based on the Safeguard Policies for environmental and social impact assessments by the International Finance Cooperation (IFC). In 2006, the EPs were revised in order to respond to the review of IFC's Safeguard Policies and their replacement by the new IFC Performance Standards (Watchman et al. 2007). As of January 2008, 59 financial institutions signed the Equator Principles, among them the biggest players in project funding worldwide, primarily, though not exclusively anymore from Western countries.

Financial institutions' seemingly limited awareness of their involvement in conflicts is noteworthy also given the heavy costs that violent strife can inflict on them. One would assume that this would be an incentive for (at least some) financial institutions to try to avoid contributing directly or indirectly to violence. This perceived indifference may partly result from the fact that some financial institutions may be complicit in violent conflicts without being directly located in conflict countries and without having their interests directly threatened by the conflict. In other cases, however, conflicts may impact financial institutions with or without any involvement of the banking sector in the emergence of violence.

The conflict risks for the financial sector can assume various forms and may differ significantly depending on the characteristics of the financial institution, the course and origin of the conflict or the governmental policies applied during the time of the insurrection (see Box 1 for a list of common conflict consequences).

Box 1: Typical direct and indirect effects of violent conflicts on the financial sector

- loss of personnel due to death or flight;
- loss of capital, e.g. due to looting;
- destruction of premises and records due to pillaging, forcing some of financial institutions to close down branches or reducing the range of products and services they provide;
- increased security spending;
- increased lending risks;
- downturn in the overall business activities as a consequence of a national economic decline, reflected in reduced investment activities, income etc. Changes in the economic environment typically have a significant effect on banks. Loans, for instance, are bank's most important product and when loan quality declines, banks can get seriously distressed;
- destruction of loan collaterals and increased uncertainty about the ownership of collateral;
- increase in bad or nonperforming loans and distressed borrowers "through the loss of markets together with the destruction of equipment" (Addison et al. 2001a: 5);
- changed customers' preferences, with typically an increased preference for foreign currency (in contrast to domestic currency) and for movable and real assets (e.g. not deposit accounts) (see for instance Addison et al. 2005);
- capital flight, which is typically hard to "repatriate";
- loss of trust;
- an insecure legal and governmental environment, which makes the enforcement of contracts and the pursuit of loan defaulters more difficult for banks;
- adverse effects because the central bank of a country is not able to adequately fulfil its functions (e.g. supervision to ensure banks' compliance with banking policies and legislations; bank registration and licensing);
- increasing cronyism in the banking sector;
- spread of informal banking practices (such as the hawala system in Afghanistan) and microfinance.

Consequences for the financial sector in a country can include a complete breakdown of the financial system; the partial and temporary interruption of the central bank with related far-reaching effects on the supervision of the banking sector and on monetary policies; or it can include the destruction of banking infrastructure in specific areas of a country or countrywide (Addison 2002). Financial institutions may in some cases even be direct targets of insurgencies, due to ideological reasons or because rebels loot branches in order to fund their fight. Addision et. al., for instance, state:

> "Different types of conflict have different effects on the financial system, and country reconstruction-programmes will reflect this. These effects include: guerrilla insurrections that disrupt the rural financial system but not the system as a whole (e.g. Guatemala), cronyism in bank lending linked to autocratic rule (e.g. the Yugoslav Federation and Zimbabwe); temporary shutdown of the financial system due to military revolts (e.g. Côte d'Ivoire and Guinea-Bissau) and secessions (East Timor and Kosovo); looting of banks to finance and profit from genocide (e.g. Rwanda); civil war that leave central banks intact but otherwise damage financial infrastructure (e.g. Somalia 1992-94); and inter-state conflicts in which formal financial institutions are stressed but continue to function (e.g. 1998-2000 Eritrea/Ethiopia war)." (Addison et al. 2001a: 11)

Most of the consequences of an armed conflict will not only be felt during the conflict period but the repercussions will linger and hamper the financial sector also after a conflict has been formally ended. It takes, for instance, time until a central bank is fully operational again or until clients have regained trust in the national economy and the functioning of its institutions. In fact, the reconstruction of a financial sector in a country is not a stand-alone activity but is deeply interconnected with reforms and recovery activities on numerous levels. Overall economic recuperation, currency reforms, or the revision of the banking legislation have to go hand in hand with post conflict financial sector recovery.

Despite the mostly negative effects of a violent conflict on financial institutions, conflicts may also bring about consequences, which - managed in an appropriate way - can turn out to be beneficial. Mansley points out that banking activities such as:

> "[…] short-term lending may continue even in conflict zones, if suitable loan security is available. Other transactions, such as foreign exchange, money transfer, and deposit-taking activities, involve lower risk for the banks and can be particularly lucrative activities, particularly if conflict conditions have reduced competition and increased profitability" (Mansley 2005).

In fact, economic activities typically continue to some extent and in some form also during a violent conflict. Most commonly, financial institutions may increase security measures, reduce the funds held liquid in their branches and change their portfolio of products and services in order to mitigate the adverse affects of violent conflicts. From some cases it is known that corporations can show remarkable creativity in developing **coping strategies**. Outstanding is, for example, the Somali business sector. Not only did the Somali Shilling continue to exist for years without a central bank in place but international money transfers and other bank services (travellers cheques, small consumer loans etc.) could be conducted through the traditional *hawala* system, which is common in many Muslim countries. Also in other economic sectors, such as in the construction sector or telecommunications, businesses continued to thrive and companies were able to partially replace governmental services and infrastructure provision. Somalia's experience may suggest that it is "easier than commonly thought for basic systems of finance and some infrastructure services to function where government is extremely weak or absent" (Nenova/Harford 2004). Market failures and other shortcomings have, however, become ever clearer the longer the governmental regulations were absent. For the financial system, this implied, for instance, a lack of business loans, since loan-giving is commonly not practiced through the *hawala* system (Nenova 2004).

In the context of "conflict-resilience", the microfinance sector is particularly interesting to look at. Overall, **microfinance** in unstable settings and its potentials for post-conflict reconstruction attracted broad interest from practitioners and academics. Less is, however, known on the impacts of armed conflict on this specific part of the financial infrastructure. Economic downturn, security issues or loss of trust may effect microfinance institutions in a similar way as other financial institutions. However, for the microfinance sector, it is widely believed that under certain minimum criteria (e.g. minimum of stability, stable population, sufficient economic activity), their operations can continue or new operations may even be launched despite the conflictive environment. In fact, political stability and formal regulatory and enforcement institutions seem to be less important for microfinance institutions than originally thought. Formal regulations are typically less important for microfinance than for formal financial institutions, making microfinance possibly better suited for politically volatile environments. Products will have to be adapted to the changing needs of clients (less loans, safer deposit facilities); management practices may have to be revised and profitability expectations may have to be scaled down, but microfinance institutions can still operate, illustrating also the continued need for financial services in conflict environments (Bruett 2004; CGAP direct 2004).

2.2 Potentials and challenges for the financial sector in peacebuilding

Generally, **the private business sector's** role in violent conflict is typically seen to have two dimensions: Firstly, a conflict-enabling and exacerbating role, as discussed above for the financial sector (e.g. Global Witness 1999; Swanson 2002). And secondly, a supportive role in conflict prevention and peacebuilding (e.g. UN Wire 5 June 2000; Nelson et al. 2000). Companies can try to prevent complicity in violent conflicts, such as by applying conflict-sensitive business practices (for example International Alert 2005) and firms can actively engage in conflict management and peacebuilding out of self-interest or philanthropic reasons. Particularly the private sector's importance in economic development, poverty alleviation, tax revenue and employment generation is frequently alluded to (for instance Bray 2006; Mierke 2006; Mills/Fan 2006).[5] Other forms of how private sector actors can engage in peacebuilding include support to diplomatic missions, awareness-raising or political lobbying for peace (e.g. Nelson et al. 2000; Haufler 2001).

The **private sector's potential** in peacebuilding has so far, however, not been fully understood or harnessed. In its analysis of public-private partnerships, the GTZ, for example, concludes that "Public private partnerships (PPP) are so far only rarely utilised to address conflict prevention and peace building and the potential of this instrument has not been fully utilised in the area of conflict prevention and peace building" (Mierke 2006). Concrete and workable ideas for constructive contributions to conflict management seem significantly less well developed than those ideas aiming to avoid negative effects of corporate activities. Although it is frequently, and probably correctly claimed that private companies are self-interested in peace, given that violent conflicts are overall economically detrimental to business operations, this does not seem to be sufficient to motivate

[5] Given the inter-linkages between poverty and the emergence or recurrence of violent conflicts, poverty eradication and development - supported by the private sector - can be important for conflict-prevention and peacebuilding. Scholarly research has demonstrated that low income per capita is associated with a higher risk of violent conflict (for a review see for instance Humphreys 2003; Rice et al. 2006). However, despite the little disputed correlation between conflict and poverty, no clear relation between inequality and the emergence of insurrections could be persuasively proven so far (Cramer 2005). The concept of horizontal inequality (inequality between social groups, such as ethnic groups) has strongly advanced the understanding of how an unequal distribution of wealth and resources can fuel violent social tensions (Stewart 2004) but more research still has to be done. If a country manages to come out of conflict, with its economic and social infrastructure typically depleted, the persistent or even enhanced poverty levels are a severe risk factor for conflicts to flare up again, snaring a country in the so-called "conflict-trap" (Collier et al. 2003).

companies to actively support conflict management. Corporations may often not be aware about their potential contributions and they may see conflict management as a purely political matter (Collaborative Learning Projects 2003a).

Yet, there are certainly inspiring examples from many conflict-ridden countries, where companies, particularly local ones have actively contributed to conflict management and peacebuilding (for examples see Banfield et al. 2006). Overall, local businesses are considered to be important players for peace, since they are assumed to be more likely to get engaged in conflict management than foreign companies (Champain 2002). **Local companies** are assumed to be more vulnerable to violent conflicts than international firms, since they do not have the same level of flexibility to disinvest and move their business operations to other places. In addition, domestic firms are commonly more familiar with the territory as well as more bound to the place, making them more likely to stay invested or resume business operations early after the cessation of violence.

Looking specifically at the finance sector, few concrete examples of (local) private finance sector engagement in conflict management and peacebuilding seem to exist. Less vague are, however, the reasons given why the commercial **finance sector's contribution** is considered valuable for peacebuilding and reconstruction efforts. One of the main rationales behind the idea of integrating the financial sector into peacebuilding is the general importance of a functioning financial service sector for economic development and poverty reduction. Economic development is considered a vital factor in reconstruction processes, when infrastructure is destroyed, growth rates are depleted and the need for a tangible peace dividend is high. When poverty or horizontal inequality belong to the conflict causes and when war economies emerge, economic development also helps to tackle the roots of the conflict and to offer alternative livelihoods. Providing financial products, such as banking services, directly contributes to poverty reduction and economic development. It enables people to better manage their risks,[6] cope with shocks, such as healthcare emergencies and market disturbances, is important to facilitate commerce, mobilise savings, enable investments in education or new machinery. In a situation where financial infrastructure is impacted severely by a violent conflict, access to investment and working capital is restricted and essential banking services are limited, impairing the overall attractiveness of a country for private sector investments (Mills/Fan 2006). Without a banking system in place companies, for instance, have to use cash payments. In situations of low physical security, however, transporting and storing large amounts of money is risky and hardly an option for business transactions. Moreover, if firms do not have access to credit on the formal market, they may have to fall back on informal financial institutions which tend to be more expensive and less reliable. An inadequate access to financial services confines, in other words, the ability of private companies to create wealth, income and jobs, which is essential in post-conflict contexts to re-integrate former combatants, provide livelihoods for returning internally displaced persons (IDPs) and a positive outlook for future developments (see also Addison et al. 2001b: 7; Bray 2005; Maimbo et al. 2006).

The **research** that has been undertaken on the financial sector in post-conflict reconstruction so far focused largely on international banks, the regulatory requirements for finical sector development, or on the role of the microfinance sector. Little is know about formal local banks and their role in peacebuilding. Addison, for instance, published widely on the reconstruction of the financial system in terms of currency reforms, central-bank reconstruction, regulatory reforms and the recapitalization of commercial banks. He discussed for cases such as Mozambique, Ethiopia/Eritrea and Rwanda, how violent conflicts affected the financial systems in these countries and which strategies were applied by national and international governmental actors to set in place the necessary prerequisites for a banking system to (re-)develop (Addison/Geda 2001; Addison et al. 2001a; Addison 2002;

[6] The positive effect of financial development has been studied extensively, among others by T. Beck; Levine, R.; Loayza, N.: (2000): "Finance and the Sources of Growth." Journal of Financial Economics (58), 137-181.

Addison et al. 2005). Bray looked more at private sector actors and their role in post-conflict reconstruction, while particularly focusing on international companies. He found that for the commercial banking sector some specialized international banks, such as Standard Chartered tend to go to emerging markets as part of their overall business strategy (for example to Afghanistan, Ivory Coast, or Nepal). Other banks invest in post-conflict societies in the context of their regional expansion strategies, such as in the case of Austrian banks investing in Bosnia-Herzegovina or a Pakistani Bank getting active in Afghanistan (Bray 2005; Bray 2006). But he concluded that "International commercial banks tend to come later, but provide a further 'building block', facilitating the work of aid agencies, foreign investors and - in due course - domestic companies" (Bray 2005: 2). Also the Multilateral Investment Guarantee Agency (MIGA) underscored the relevance of private sector help in rebuilding conflict-affected countries, but looks primarily at foreign direct investments. In Afghanistan or Bosnia-Herzegovina, for instance, an investment guarantee facility was set up to "facilitate the development of the local private sector", including the financial infrastructure (see www.miga.org).

Overall, (foreign) financial sector actors are found to be a risk-averse branch. A stable political environment, decent level of security and a well-established legal framework are considered essential pre-conditions that have to be fulfilled before new banking investments are considered (see, however, also the paragraphs dealing with microfinance institutions). In post-conflict settings, the investment climate for banks is typically bad, easily eschewing banks from realizing investments. If a bad risk scenario is accompanied by small markets, the appeal of the place is low for an international bank. While some conflict-prone countries, such as Angola, Iraq or Nigeria may appeal to banks because they promise profitable long-term prospects, many others emerging from violent conflict such as Cambodia, Guatemala or Nepal have a low market-attractiveness for international banking investments (Bray 2005). In fact, many of the weaknesses that commonly deter banks from investing in developing countries (e.g. lacking regulation, small markets), are aggravated in conflict-affect countries. Weak banking legislations, a lack of central-bank supervision and regulation, inadequate law-enforcement as well as insufficient skills often go along with debilitated social trust, little or no documentation, absence of physical collateral, inadequate infrastructure, and a higher risk of non-performing loans (Addison 2002).

Other foci in the current research landscape on the role of the financial sector in post-conflict settings are microfinance institutions (MFIs), as mentioned in the previous chapter, as well as the role of remittances. The potential of MFIs has been explored from various angles, in particular its role in reconstruction has been emphasised (see for instance Bruett 2004; CGAP direct 2004; Nagarajan/McNulty 2004). Similarly, some authors highlighted the importance of remittance-transfers, arguing that remittances can be a "nucleus" for rebuilding a financial system. Munzele Maimbo states, for example: "In recent times, Somalia and Afghanistan typify the ultimate example of the financial sector's ability to use the remittance business as the nucleus of financial sector activities during the period of conflict as a life-line to a people afflicted by sustained conflict, and as a basis for rebuilding a new financial system on cessation of active conflict" (Maimbo 2007: 26). Given the fact that formal international financial sector actors typically come relatively late after the end of a violent conflict, examining the potential of informal financial service providers for peace seems very relevant - specifically for the earlier stages of a reconstruction and peacebuilding period. For water providers it is, for instance, known that small local, often unregulated service-suppliers are typically the first to offer services in post-conflict settings, at a time when international companies are not yet willing to enter the still volatile country (Schwartz et al. 2004). Similar things are known from financial services. In Afghanistan, for instance, businesses and NGOs have used the local *hawala* services, which provid currency exchanges, deposit services and money transfers, due to inadequate formal banking services. Although the informal service provision may be insufficient in the long-run and of sub-optimal quality, at a time when other players are not yet able to supply services, this is better than nothing (Center for Advanced Defense Studies 2006; Maimbo 2007).

So far, the research hardly looks at the potential role of local commercial financial actors. In fact, many case studies addressing the subject of financial sector development in post-conflict settings have been realized in countries where the formal financial sector was nearly fully depleted, such as Somalia or Afghanistan. But many countries coming out of war still have some kind of formal financial services, such as Guatemala, Sri Lanka, or Nepal. These countries provide a different scenario, where the existing formal structures can possibly be drawn on.

Areas of activity for financial institutions in peacebuilding

It is noted several times throughout the report that "very little useful information has emerged to guide financial firms towards engagement in post-conflict reconstruction" (Switzer/Hussels 2004: 9). The focus of the following paragraphs is to present and further develop ideas for local financial sector contributions to peacebuilding as well as to discuss their limitations. It is differentiated between three areas of engagement: activities that fall into the core-business activities of financial actors, conflict-sensitivity related activities, and activities in the field of social investment.

In principle, what a financial actor is able to do, what it is willing to do and what is appropriate to do depend on a broad range of factors. Essential is how the financial sector was affected by the conflict, what the (most pressing) needs are with regard to the reconstruction and peacebuilding process, and if (and when) there is room for engagement for financial actors. Separatist conflicts, for instance, that result in new states (e.g. in ex-Yugoslavia) or conflicts where the financial sector was an explicit target of the insurgency have very different starting positions for financial actors than low-intensity conflicts. While in the first setting a new currency, central bank regulations etc. have to be installed before private-sector engagement can flourish, banks in low-intensity conflict settings may more easily get active. Moreover, a financial actor that was severely affected by a conflict may struggle to devote the necessary resources. On the other hand, however, it also has to be considered that if the financial sector may not have felt the negative consequences of a conflict, the economic self-interest to motivate a financial actor to support peacebuilding, may be low.

I. Core business activities

Offer new products, developed according to the specific post-conflict needs.

1. With regard to offering new products that are specifically developed to address post-conflict needs, UNEP FI suggested setting up "Professionally managed investment funds for diaspora communities seeking to contribute to post-conflict reconstruction", in order to better harness the inflow of remittances (Switzer/Hussels 2004: 27).[7] The establishment of efficient and ***client-oriented services to transfer remittances*** could be a vital contribution to reduce poverty and facilitate investments in countries coming out of war. Developing effective ways to utilize remittances is, however, challenging. Already in peaceful environments, the transfer of funds by migrants to their countries of origin can be tricky. In situations of violent conflicts or in immediate post-conflict settings, it can be even more difficult, partly because remittance transfers during conflict situations have been discredited by examples of these funds supporting insurgencies (Weiss Fagen/Bump 2006). Such cases of misuse have led to governments increase efforts to regulate the flow of remittances, particularly of funds that are channelled through informal mechanisms, such

[7] More often than not, countries beset by conflict have a considerable diaspora community, since violence forces people to leave their home-country, often in a large scale. Money transferred by migrants to their countries of origin are a vital source of funding for those that are not able or not willing to leave and can play an important role for economic reconstruction and revitalization. In fact, "research shows that migrants transfer funds and invest in their countries of origin at times when international investment has all but disappeared" (Weiss Fagen/Bump 2006: i).

as the *hawala* system. The regulations make the system less prone to abuse while, however, restricting at the same time modes to transfer money for migrants.

2. The design of specific **"reconstruction loans"**, characterized by longer repayment periods and fair interest rates, particularly for small and medium companies could be another type of product to be developed in post-conflict contexts. Private companies are typically compromised by violent conflicts and may not be able to meet standardized loan requirements. Instead of having to go to informal credit sources or not be able to invest at all, banks may be able to provide softer loans to companies. Banks may therewith directly help to stimulate investment, economic growth and employment generation.

3. As mentioned earlier, microfinance institutions are considered to be - under certain preconditions - a good tool to invigorate economic activities in countries coming out of war. **Fostering of microfinance institutions** could be directed at particular conflict-affected target groups, such as internally displaced persons (IDP) or at the population as the whole. Reintegrating IDPs, for instance, who had to flee their homes is important for the overall stability in the country. In post-conflict countries such as in Afghanistan, Rwanda or Cambodia, microfinance has been included in peacebuilding efforts, sometimes with surprising success. Although microfinance clearly targets a certain fraction of the market and are not able to cover all credit requirements of a country, it can positively impact poverty-reduction, self-employment etc. The banking sector could support the establishment of microfinance bodies, by refinancing microfinance institutions, setting up microfinance businesses themselves or supporting capacity building in existing microfinance institutions.

Secure and mobilise funds for key infrastructure developments.

The need for infrastructure reconstruction is typically high in post-conflict settings but funds are mostly scarce. Infrastructure is a pre-condition for national economic growth and the reconstruction of infrastructure is a direct growth impulse for the economy. Although international donors may pledge significant amounts of funds for rebuilding necessary facilities, the inflow of donor money normally abates after about five years (Collier et al. 2003). In order to generate necessary additional funds either at the beginning of a reconstruction period or in order to compensate for the declining aid-money after the initial peak, private financial institutions could play an important role. Providing money for infrastructure investments such as by establishing thematic funds would be an option. Given the typically high risks that dominate post-conflict contexts, specific financial instruments such as bonds, which reduce risks may be the most appropriate tool. Similarly, offering political risk insurances (such as those offered by MIGA) may be a useful way to encourage banks into supplying funds to infrastructure investments (Schwartz et al. 2004; Switzer/Hussels 2004).[8]

II. Conflict-sensitivity

As mentioned before, private sector activities can have unintended negative effects on conflicts. They can contribute to a further escalation of violence and sustain warfare. In order to avoid

[8] With the World Bank's Multilateral Investment Guarantee Agency (MIGA) and similar national risk insurance projects such as the UK Export Credit Guarantee Department (ECGD) or the US Overseas Private Investment Corporation (OPIC), international and bilateral donors have an instrument at their disposal, with which some of the political risks in post-conflict settings can be mitigated. Experiences suggest that banks are among those sectors that most appreciate PRI. Moreover, given the catalyst function of the banking sector for other investments, it makes strategic sense for PRI-institutions to emphasise the support of the banking sector in early post-conflict periods. Yet, viable business opportunities and an appropriate business environment still remain essential preconditions before PRIs can help to spur companies into realizing investments (Bray 2004).

negative economic consequences and enhance potential positive effects, actors active in the wider context of conflicts, such as development agencies, increasingly use conflict-sensitive approaches for their activities, analysing the (potential negative and positive) effects of their operations on a conflict setting. With respect to the financial sector, conflict-sensitive business practices have been so far only discussed for project funding (see International Alert 2006). Microfinance institutions have looked at their linkages with conflict to some extent, but seemingly not in a systematic manner.

Conflict-sensitivity for the financial sector could include numerous dimensions, depending on factors such as the conflict-context, its root causes or the type of financial activity addressed. On a local scale, for instance, conflict-sensitivity can be important when financial institutions give loans to poppy-farmers whose revenues fund conflict groups or when ethnically segregated lending or hiring practices are common. Conflict-sensitivity should also be applied when banks try to positively engage in peacebuilding. Merely good intentions does not prevent activities from having unintended conflict-aggravating effects (see for instance Anderson 1999). If a bank, for instance, wants to set up a microfinance fund as a contribution to post-conflict peacebuilding, the fragile social and political environment demands for a careful and conflict-sensitive approach. Yet, overall, not enough experiences have been made so far with conflict-sensitivity in the financial sector.

III. Policy dialogue and social investment

Less specifically directed towards financial sector actors are "policy dialogue" and "social investment" as additional areas of engagement for financial institutions. While it is relatively easy to state what is **special and specific** about the contributions of the financial actors in the areas of "conflict-sensitivity" and their "core business operations", it is less clear how financial actors' contributions differ from contributions of other business sectors in the fields of "social investments" and "policy dialogue".

Business support to **"policy dialogue"** typically describes companies' role in advocating for peace and promoting good governance and human rights. In some cases, public policy dialogues on peace processes are established, in which private actors can participate. Overall, public policy engagement is difficult to define and an area that can be a slippery slope for companies to step on, since there is no clear understanding about what their legitimate role may be. If companies engage "too much" in policy issues, they can easily be criticized for interfering in areas that are not considered "their business".

Similarly broad is the field of **"social investment".** For many companies, activities such as establishing schools or providing money for sporting grounds is a typical social investment activity. Social investments -realized individually or as joint projects with other companies - do not necessarily have to have a link to a company's core-business competencies, but they certainly can. Specific philanthropic activities in support of conflict-mitigation and peacebuilding can include "engagement in knowledge sharing with the public sector" (Switzer/Hussels 2004: 8) or supporting humanitarian activities. But also activities in the field of microfinance can be considered social investments. A prominent example is the foundation by Dutch Rabobank, which seeks to contribute to poverty eradication and development promotion through the provision of microcredit (Switzer/Ward 2004). With USD 60.5 trillion (in 2005) worth in assets held by the 1,000 largest banks, the shear size of the banking sector worldwide raises expectations about bank's capacity for social investments (International Financial Services 2006). In fact, that companies, including banks, engage in social investments is relatively common, since many firms see it as a way to enhance their reputation and to "appease" communities that may oppose an investment. Yet, social investment can have negative side effects, especially in volatile conflict settings. Philanthropic activities have to be carefully analysed, implemented and monitored in order not to cause harm (Collaborative Learning Projects 2003b).

The information provided in the previous paragraphs suggests the following **main conclusions** concerning options and limitations to integrate financial actors into peacebuilding:

1. The financial sector has potential with regard to contributing to peacebuilding and conflict transformation through its core business activities, conflict-sensitivity, social investments and policy dialogue. Many of the ideas for financial sector engagement are similar to those that have been discussed for other economic sectors or the private sector as a whole. Yet, the financial sector, including the local financial sector, can be assumed to have a **particular role** to play given its catalyst function for economic development and reconstruction efforts. For the microfinance sector, this role is already widely recognized.

2. A challenge for any of the suggestions made on how financial actors may contribute to peacebuilding is the need to **strike a balance between the financial institutions' need to stay profitable and their social responsibility.** It is neither realistic nor desirable that financial institutions "turn into aid organisations". Ideally banks can realize peace-supporting initiatives on a win-win basis, with benefits for a country or community additional to profits for themselves. But for many initiatives, it needs an altruistic motivation or inspiration.

3. Integrating the financial sector into peacebuilding can make a relevant contribution to peace but it is **not a panacea** for peace and stability. In some cases, there may not be any room for financial sector contributions, because the conflict setting does not allow for their engagement or because the financial sector is not in a position to assist. Financial sector development has to be embedded in a broader set of reforms and initiatives. Just on its own, it is unlikely that financial sector development can take off and make a significant contribution to the prevention and transformation of conflicts. From the microfinance sector in post-conflict countries, it is, for example, known that grants are sometimes a better option than loans, when, for instance, the beneficiaries are too distressed by the conflict to be able to generate the necessary cash flow to repay a loan. Similarly, giving out microfinance loans to ex-combatants as a reintegration measure often generates little success as former rebels are typically not entrepreneurial enough to make good microfinance clients (USAID 2004). In some cases, financial institutions may simply not be in the position to support peacebuilding, since they were too hard-hit by the conflict themselves. Political Risk Insurances or other types of support may motivate private companies to embark on reconstruction and peacebuilding activities but they cannot guarantee support if basic preconditions are not fulfilled.

4. One-type-fits-all-solutions would not work in the highly context-dependent environments of post-conflict countries. For each country a comprehensive and detailed **needs assessment** is required that should formulate the basis for any strategy to involve the financial sector into post-conflict pecebuilding efforts. Central questions that should lead the assessment are: What were the economic consequences of the violent conflict on the national economy? What are the general economic conditions? What are the specific consequences of the conflict on the financial sector? Where are the most pressing needs for reconstruction and post-conflict development?

Case Study Nepal

3 Brief overview of the violent conflict and the peace process in Nepal[9]

In 1996, the Communist Party of Nepal took up weapons to launch the "People's War" in Nepal. Among the main goals of the insurrection was the abolishment of the monarchy as well as economic and social reforms in favour of the poor and disenfranchised parts of the population. Over the following years, the rebellion developed into a powerful conflict, considered by some as one of the most important guerrilla movements of the last decades. The signing of the "comprehensive peace agreement" (CPA) between the Nepalese government (Seven Party Alliance) and the Maoists in 2006, formally ended the violent conflict but the following months revealed the fragility of the newly established "peace". Political turmoil, postponements of the constituent assembly elections, and newly erupting conflicts in the South of the country characterised the political and social climate. Only by the end of December 2007, was a settlement reached, including an agreement to hold constituent assembly elections in April 2008 and a forestalled decision to end the monarchy in Nepal. In the summer of 2008 the constituent assembly then voted in a new president of Nepal, the Nepali Congress candidate Ram Barab Yadav.

The emergence of the violent conflict between the Maoists and the Nepalese government can be traced back to a complex web of **structural and immediate causes.** In fact, long before the Maoists began their armed struggle, political and social conflicts had sporadically erupted into violence as manifestations of deeper-routed grievances and imbalances in the country.

Politically, the conflict in Nepal was rooted in repeatedly frustrated attempts since the 1950s to establish reforms and a democratic system. Nepal looks back on a political history dominated by the rule of recalcitrant, aristocratic families and enduring conspiracies for the supremacy in the country. Between 1846 and 1950, the Rana-family tightfistedly ran the state through a succession of Rana prime ministers and allied landed aristocrats. After the king reassumed power in 1951, he introduced reforms such as the elimination of bonded labour and the abolishment of *birta lands*, a system that was installed by the Ranas to reward their allies with landholdings. Yet, the monarch still governed almost unrestrictedly and did not allow for elections. When Nepal held its first general elections in 1959, the sovereign was not yet prepared to share power with political parties and dismissed the cabinet under emergency rule only about a year after the elections. The subsequent introduction of a new constitution and the *Panchayat System* resulted in few real changes in the king's position. The Panchayat democracy prohibited political parties and the installed system of councils (*panchayats*) and a national legislature *(rastriya panchayat)* had de facto limited leverage over the king. With some - mostly cosmetic - changes, the Panchayat system persisted for nearly forty years. Only the formation of a vocal pro-democracy movement forced King Birendra in 1991 to dissolve the system and to install a multiparty democracy.

But the newly elected government could not prevent the country from suffering endless political infightings between the different political parties. In the following years, governments changed quickly, none of them being able to surmount the internal political struggles. As a consequence, hardly any significant changes in the political, social and economic realm were achieved. To the contrary, corruption became a widespread phenomenon, undermining the trust of the people in the governmental institutions (Adams 2005). In 2001, the line of events following the royal massacre

[9] This chapter is based on a range of sources, including International Crisis Groups website (specifically the Nepal website http://www.crisisgroup.org/home/index.cfm?id=1265&l=1), as well as publications by David Seddon, Thania Paffenholz and other authors (Seddon 2005; Paffenholz 2006).

and mounting human rights violations strongly demoralized the population. The people of Nepal had hoped that the introduction of a democratic system in 1991 would bring greater political freedom, social advances and economic progress, but they saw themselves confronted with continued elite power, abuse and economic decline.

Socio-economically, the causes of the conflict are commonly ascribed to pervasive poverty, widespread inequality between rural and urban areas as well as exclusion along ethnic, caste and gender lines that have plagued the country for centuries. In many aspects, the socio-economic causes of the conflict are closely linked to Nepal's ill-fated political history. Amidst the underlying harsh living conditions, the state failed to offer reliable politics that benefited the poor and disadvantaged (Seddon 2005).

Still today Nepal **belongs to the poorest countries** in the world and it is the poorest country in the SAARC region (South Asian Association for Regional Cooperation) in terms of per capita GNI (USD 250 in 2004). Also with regard to the Human Development Index (HDI), Nepal ranked in 2006 only on position 138 out of 177 countries and was therewith third last among Asian countries before Papua New Guinea and Timor-Leste.[10] About 30 per cent of the national population lives below the poverty line (2004), and at the time when the Maoists took up arms, incidences of poverty were 42 per cent, rising from a level of 33 per cent in 1976/77 (World Bank et al. 2006).

Inequality is pronounced, with Nepal being the country with the highest Gini Coefficient in Asia (over 45) (World Bank et al. 2006; ADB 2007). Specifically horizontal inequalities along ethnic and caste lines were prominent and even increased with liberal economic reforms in the 1990s, although the caste-system was abolished in 1963 and the constitution of 1990 prohibited discrimination based on ethnicity, caste, religion or race (Deraniyagala 2005; Geiser 2005; Murshed/Gates 2005). Poverty continues to be highest among the rural population, among lower castes (e.g. Dalits) and some ethnic groups. Levels of human development also vary significantly between ethnic groups and castes. For instance, while literacy rates among the upper castes is about 50 per cent, literacy among lower castes is only about 30 per cent (Deraniyagala 2005). In addition, rural regions in the country, in particular the West, are characterized by lower human development indicators and more unequal distribution of land. By the mid 1990s, for example, only 20 per cent of the urban population was below the poverty line in contrast to 44 per cent in rural areas (Sharma 2004: 2). Rural areas were frequently not given sufficient attention in development projects, although agriculture (primarily subsistence agriculture) is still the most important sector for the country in terms of the absorption of workforce. Reforms addressing bonded labour *(kamaiya)* - which was only officially abolished in 2000 - feudal structures in landownership, and widespread landlessness *(sukumbasi)* were often half-hearted and only partially successful. Agricultural productivity is low and given the sluggish industrial development, alternative job-generation outside the agricultural sector is overall insufficient, resulting in high levels of poverty and unemployment, especially among the youth (Deraniyagala 2005; Murshed/Gates 2005). Today, a modern private business sector is only in an incipient stage. Main industries include jute, bricks, cement, cigarettes, sugar, beer, garment and carpet industries and it remains to be seen if these industries can survive, given Nepal's accession to the WTO in 2004 and the end of preferential trade agreements and quota systems for some of its products (Tibrewala 2004).

Looking at economic data, Murshed and Gates concluded that "inequalities worsened in recent years, and group differences based on caste and ethnicity are central to explaining the genesis of the present conflict" (Murshed/Gates 2005: 10). In fact, the **Maoists** knew to capitalise with their

10 The statistical information is based on Asian Development Bank (2007): Key Indicators 2006. http://sdbs.adb.org:8030/sdbs/index.jsp. Accessed 14 November 2007. For the Human Development Index see: http://hdr.undp.org/en/statistics/. Accessed 13 October 2008.

Marxism-Leninism-Maoism **rhetoric** on the political and economic grievances of the population.[11] They defined their rebellion in class-terms, as a struggle between the Maoists and the government that stood for the traditional system of the country but they also gave allowance to ethnic and caste dimensions. The Maoists' goal to abolish the Monarchy was an expression and symbol of a fight against the feudal and elite structures that prevented reforms for the poor and disadvantaged for decades (Mishra 2006). Over the course of the conflict, this rhetoric was increasingly successful in generating support among the lower castes, Dalits and ethnic minorities, which appear to "have begun to consider the rebel movement as a vehicle for challenging the economic and social domination of upper castes and elite ethnic groups" (Deraniyagala 2005: 53).[12]

A list of demands (40-point memorandum) that the Maoists - under the leadership of Baburam Bhattarai - published shortly before they took up arms, illustrates the political and economic elements that - embedded in the Maoists ideology - appealed to a large number of followers.[13] The memorandum included, for instance:

- A new constitution should be drafted by representatives elected for the establishment of a people's democratic system.
- All special privileges of the king and the royal family should be abolished.
- The domination of foreign capital in Nepalese industries, business and finance should be stopped.
- An appropriate customs policy should be devised and implemented so that economic development helps the nation become self-reliant.
- Land should belong to "tenants". Land under the control of the feudal system should be confiscated and distributed to the landless and the homeless.
- The property of middlemen and comprador capitalists should be confiscated and nationalised. Capital lying unproductive should be invested to promote industrialisation.
- A minimum wage for workers in industries, agriculture and so on should be fixed and strictly implemented.
- Poor farmers should be exempt from loan repayments. Loans taken by small farmers from the Agricultural Development Bank should be written off. Appropriate provisions should be made to provide loans for small farmers.

Given these social and economic roots of the conflict, it is not surprising that the armed struggle started in the Mid-Western districts, where poverty is among the highest in the country and human development levels among the lowest. In addition, the growing sympathy for the Maoists in the early years after the beginning of the armed struggle, was considerably propelled by their activities against corrupt officials, exploitative landowners, moneylenders, and local officials. In the early years of the new millennium, the geographic centre of the conflict then expanded from mainly the rural, Western parts of the country to the cities (including Kathmandu), the Eastern regions, and the Terai in the South. By the beginning of 2004, the Maoists had managed to control about 80 per cent of

[11] Leftwing and communist parties have a long tradition in Nepal. The first Nepalese communist party was founded in 1949. Since then, the communist movement underwent many ups and downs and numerous splits and infightings (Sharma 2004b). With the Maoists taking up arms, they brought their political struggle to a new level. The majority of the leftists are now united in the Communist Party of Nepal (Unified Marxist Leninists), but there are numerous smaller groupings further to the left with the (Communist Party of Nepal) Maoists at the farthest left.

[12] The Maoists could later also expand their support base among the urban poors and parts of the "middle-class" that did not see the expected political and economic changes happening in the 1990s (Seddon 2005).

[13] Based on a copy of the 40 point memorandum, published on the South Asia Terrorism Portal: http://www.satp.org/satporgtp/countries/nepal/document/papers/40points.htm. Accessed 13 October 2008.

the rural areas and they were present in some form in almost all of the 75 districts. The process was accompanied by disruptive strikes, intensified violence, excessive use of force and a high number of human rights violations. The increased influence of the Maoists in the country became an immediate threat to the state and its elites, a "disruption of traditional local social structures and practices [that …] can also be seen as a liberating process, enabling those previously locked into positions of subordination and subjugation to be freed of these ties and obligations in a hitherto unprecedented fashion" (Seddon 2005: 24).

Yet, given the apparent significance of **socio economic factors** in the emergence and escalation of the conflict, it is surprising that in the CPA signed by the Maoists and the Seven Party Alliance - a coalition of seven political parties, aiming to end autocratic rule in Nepal - economic factors are clearly subordinate to political issues.[14] The peace talks culminating in the CPA in 2006 was preceded by two earlier attempts to bring peace to Nepal in 2001 and 2003. The Maoist's main goal in the peace talks was the abolishment of the Monarchy and the establishment of a new constitution. But most of their other demands remained rather vague. The International Crisis Group wrote, for example, in 2005:

> "Despite the Maoist's rise to prominence and the growing international concern at their threat to Nepal's established polity, surprisingly little is known about them. […] The Maoists themselves have fed the confusion over their true aims with a plethora of seemingly contradictory statements" (International Crisis Group 2005: 1-2).

The Maoists were presumably not prepared to negotiate economic issues in detail (interviews Kathmandu, 23 Sep to 4 Oct 2007). In addition, it is likely that changes in the political set-up were seen as a precondition and path to realize economic changes. Hence, in the CPA, the most relevant provision made was the constitutional assembly election, first scheduled for June 2007. The constitutional assembly was foreseen to make final decisions on the role of the king. In the economic realm, the accord made the following agreements:

- end all form of feudalism and prepare and implement a minimum common programme of socio-economic transformation on mutual understanding;
- end feudal land ownership and formulate the policies for scientific land reforms;
- adopt policies for protection and promotion of national industries and resources;
- adopt policies to provide land and socio-economic security to backward groups like landless, bonded labourers, and other groups, which are socio-economically backward;
- adopt policies to take strict actions against the people who have worked in government positions and have amassed huge amount of properties through corruption;
- prepare a common development concept that will help in socio-economic transformation of the country and will also assist in ensuring the country's economic prosperity in a short period of time;
- follow policies ascertaining the professional rights of workers and increase employment and income generating activities.

In addition, the parties agreed to end the collection of war taxes or extortion money, as well as to stop the illegal seize or capture of private property. The Maoist leader, Prachanda, later stated in one of his first public addresses that the Maoists would opt for a "mixed economic policy", including drastic changes in the pattern of land ownership, while supporting "big capitalists" and allowing

[14] For a more general discussion on economic dimensions in peace processes see, for instance, a recent publication by Achim Wennmann (Wennmann 2007).

them to make profits. He also reiterated that "the party would promote national capitalists and make the country less dependent on foreign capital" (nepalnews 2007). To the private sector these statements sent mixed messages. While not fighting a free market order in principle, the Maoists made clear that foreign capital as well as the landed elite and large landowners would have to face losses.

The time after the signing of the comprehensive peace agreement was complicated by the escalation of new conflict lines in the South of the country. In the Terai, the ethnic Madhesis launched violent protests, declaring the interim constitution and electoral system as discriminatory. Strikes and violent clashes continued to plague the Southern regions of the country, undermining the peace process as a whole and taking a significant toll on the private sector (see below). The subsequent political moves, such as the abolishment of the Monarchy, the constituent assembly elections, as well as the election of a new president are important steps towards a more peaceful Nepal. If the new conditions with the Maoists in the government are stable, this will be shown in the future.

4 Overview of the financial sector in Nepal

Nepal's geographic position as a land-locked country sandwiched between the economically powerful neighbours of China in the North and India in the South is an often cited factor for **Nepal's slow economic development** mentioned in the previous chapter. Other structural aspects include the poor endowment of exploitable resources, the difficult topography, which restricts farmable croplands and makes infrastructural development difficult, wide-spread corruption and political instability (Dahal 2004), as well as the fact that "Nepal has begun its real development process only since the 1950s when the country was relieved from the century-long family rule by the Ranas, followed by the evolution of democracy in 1951" (Tibrewala 2004: 288).

The overall low economic standard in Nepal clearly also influenced the development of the financial sector in the country. However, in the last two decades, the **financial sector landscape in Nepal changed drastically** in terms of depth of financial services as well as in terms of the range and quantity of financial intermediaries and may have turned the financial sector into one of the most dynamic sectors in the Nepalese economy. Financial activities, measured by households taking loans, went up slightly from 61 per cent in 1993/94 to 69 per cent in 2003/04 (World Bank et al. 2006) and the number of financial service providers went up from only five licensed institutions in 1980 to 180 in 2005. 17 commercial banks (both private and state-owned), 25 development banks, 59 finance companies, four microfinance development banks, five regional rural development banks, 20 financial cooperatives, 47 financial NGOs, and three wholesale institutions were officially registered. In addition, a plethora of unregistered financial cooperatives and NGOs are active in Nepal. Approximately 2,300 financial cooperatives and 15,000 financial NGOs are estimated to be operating throughout the country (World Bank 2007).

Despite significant progress made in expanding financial services over the last decades, **financial service provision is still insufficient.** About a fifth of the national population is not financially served at all and more than a quarter has only access to informal financial institutions, such as family members, moneylenders, shopkeepers or landlords. In fact, a World Bank study suggests that access to financial services (measured in number of loan accounts, number of deposit accounts and the number of people per bank branch) declined again since the beginning of the new millennium (see also chapter on effects of the violent conflict on the financial sector) (World Bank 2007). Access to financial services is worse in rural areas and among the poor population. Although financial NGOs and cooperatives serve the rural and poor segments of the population also in the Far- and Mid-Western Regions to some extent, the dependence on informal providers of financial services is still particularly high in these regions. But also in some urban areas, the importance of informal lending remains prominent. The main sources of informal lending are family and friends as well as moneylenders. Moneylenders tend to be more active in rural areas and among the poor (though not the poorest) parts of the population (World Bank 2007). The Asian Development Bank (ADB), estimated that formal rural finance institutions only cover about ten per cent of the possible demand in terms of lending volume (ADB 2006). In addition, whereas more than half of the population in rural areas does not have a bank account, only about a quarter of the population in urban areas is without an account. Indeed, while the rural areas and poor people can be considered "under-banked", competition between financial providers in the market segment of the wealthy in urban areas, particularly in the Kathmandu valley, is high due to the steady increase in the number of financial intermediaries in these places (World Bank 2007).

The dependence on the informal sector is largely a consequence of the **formal sector's inability to sufficiently meet the demands of the people.** While the informal provision of services is not necessarily a bad thing, severe problems may arise concerning lacking legal accountability or excessive interest rates. Interest rates by moneylenders range, for instance, between 36 and over 100 per cent per annum. "In addition, they often receive either labor services or other small gifts as part of the loan request" (Dhakal 2007: 7). In Nepal, moneylenders are also a symbol of the feudal social structures, undue exploitation of the poor and long-term dependency, making them a frequent target of Maoists' during the conflict.

Governmental efforts over the last 50 years to **improve the access to formal financial services** did not have the expected effects. Among the most important policies that the government introduced over the last decades were:

- Directed lending programmes for priority and deprived sectors. The priority sector lending programme requires banks to lend four per cent of their loans to small businesses and other priority sectors. The deprived sector lending programme obliges banks to lend three per cent of their loan portfolio to low-income households, either directly or through intermediaries, such as microfinance institutions. The priority sector lending programme was phased out in 2007, since it did not have the expected effects. The deprived sector lending programme is still in practice but also faces difficulties since many banks prefer to pay fines for non-compliance with the deprived sector lending policy than meet the three per cent target. In fact, as of mid 2005 eleven out of 17 banks preferred this option (World Bank 2007).
- A policy requiring banks to open branches outside the Kathmandu valley. For branches that a bank opens in the Kathmandu valley, it has to open branches outside the valley. Compliance with this policy is also flawed.
- Introduction of new types of financial institutions with lower capital requirements, such as finance companies in order to raise the number of financial intermediaries in Nepal. The policy has in fact led to a mushrooming of finance companies and development banks.[15] Yet, many of those are concentrated in urban areas.

Among the most important finance service providers in Nepal are **financial NGOs and cooperatives.** They are of specific relevance in rural areas, for the poor, and for the provision of household loans. Financial NGOs and cooperatives, however, have been criticised for lacking capacity and professional staff, inadequate products, and fragile performance. The plethora of small financial NGOs and cooperatives typically lack the size and institutional capacity to be able to work sustainable (BWTP 2004). The idea of microfinance provision as a "charity activity" that is not required to work profitably is still widespread. Expansion into underserved regions of the country (such as relatively inaccessible to reach hill and mountain areas) remained sluggish despite high levels of liquidity, which exists due to the deprived sector lending policy, mentioned above. Nepal's difficult topography and insufficient infrastructure, the low population-density in mountainous areas as well as unclear and insufficient legal regulations are key factors hampering an expansion of the sector. Although efforts are made to improve capacity of these institutions (e.g. such as through the establishment of resource and training centres), much still remains to be done (Dhakal 2007; World Bank 2007).

Also part of Nepal's microfinance market are the five **Regional Rural Development Banks** (RRDB), which were designed according to the model of Garmeen Banks.[16] The banks were established between 1992 and 1996 in the five different development regions of the country and started as state-owned institutions (BWTP 2004; World Bank 2007). Although a restructuring process was initiated, including the privatization of RRDBs, they are not performing well. Undue overhead costs, loss of trust by depositors and a narrow level and area of operations seem to be central challenges for these institutions (Basyal 2004).

---

15 In the last years, many NGO microfinance institutions transformed themselves into development banks under the Development Bank Act of 1996 (Wehnert/Shakya 2003).

16 The Grameen Bank approach is a group-based credit approach for which no collateral is required. Peer-pressure is used instead to ensure that borrowers pay back their loans.

In contrast to most other financial actors in the country, **private commercial banks** have performed well overall over the last years. The absolute majority of private commercial banks could report operating profits although some of the private commercial banks were struggling with non-performing loans or capital adequacy requirements.[17] Most private commercial banks started their business in the early and mid-1990s after a first financial sector reform was launched in 1984 and when Nepal's economy was growing at a decent rate. Private commercial banks are either fully Nepali-owned (such as the Bank of Kathmandu) or are operated as joint-ventures (for example Standard Chartered Bank; Nabil Bank; Everest Bank).[18] A ceiling on foreign ownership (66 per cent since 2001; before 50 per cent) prohibits banks to be fully owned by foreigners. The group of private commercial banks is dominated by some bigger banks, including Himalaya Bank, Nabil Bank and Standard Chartered, but competition among private commercial banks increased over the last years given the steady rise in financial intermediaries in Nepal. Overall, private commercial banks are considered to provide better services to their clients, with a larger and more suitable range of products, more efficient service provision and a more professional management than state-owned banks. Yet, private commercial banks primarily serve the urban areas and are strongly concentrated in the Central region of Nepal, with 46 per cent of their branches in this region - although there is some indication that commercial banks have recently started to spread out to urban areas outside the Kathmandu valley as well as to some more rural regions (World Bank 2002).

A major challenge for Nepal's financial sector is the performance of the **state-owned banks**, Nepal Bank Limited, Rastriya Baniya Bank and the Agricultural Development Bank, in particular. In fact, the threat of a critical financial sector crisis triggered by the bad performance of these financial intermediaries alarmed international players and prompted the beginning of a comprehensive financial sector reform process in the last years.[19]

The state-owned commercial banks established the biggest network of branches, with a large presence also in Nepal's rural areas. Together they comprise about two thirds of the existing bank branches, owning more than ten times as many branches in rural areas in 2001 than private commercial banks (World Bank 2002; World Bank 2007). However, public commercial banks are notorious for high rates of **non-performing loans.** "Rastriya Banijya Bank and Nepal Bank Limited together, account for more than 80 per cent of total NPLs [non-performing loans] of the banking system, compared to less than 20 per cent in the other 15 commercial banks" (Sharma 2006). The problem of defaulters and non-performing loans is massive and problems related to the recovery of loans are severe. According to one estimate, the Nepal Bank was only able to recover Rs 5 billion of its nearly 21 billion in bad loans between 2002 and 2004 (Singh 2004). The problem of willful defaulters in Nepal is not only an economic but also a political issue that massively undermines the trust of the general citizens in the banking system of the country as well as the jurisdiction (see for instance Ohashi 2006).

The main reasons for the poor performance of state banks are politically directed lending and bad payment behaviour; inefficiency and overstaffing; poor service; weak accounting and limited computerization; inadequate products and bad management, going along with a weak and fragmented legal framework for commercial banking and insufficient oversight by the Nepal Rastra

---

17 According to an IMF report from 2006, "four private commercial banks did not meet capital adequacy requirements at end-2005/06, and three had NPLs [non-performing-loans] in double digits" (International Monetary Fund 2006: 13).

18 Joint venture partners are mainly from Bangladesh, India, Pakistan, and the UK.

19 Nepal Bank Limited - the oldest bank in Nepal - was founded in 1937 and is now earned to 41 per cent by the government. Rastriya Baniya Bank was established in 1966, is fully owned by the state and is the largest commercial bank in Nepal. The Agricultural Development Bank was founded in 1968 and is largely owned by the Nepal Rastra Bank (Central Bank) and the government, with a small percentage being held by small farmers.

Bank. The financial sector reform that was initiated in response to the crisis of the banks has focused so far largely on improving the legal and regulatory framework, strengthening the Nepal Rastra Bank, and restructuring the troubled public commercial banks. Although the reform process has made significant progress, much remains to be done, on issues such as the capacity of the Nepal Rastra Bank or the recovery of loans from large willful defaulters (International Monetary Fund 2006; International Monetary Fund 2007).

To sum it up: The financial needs of most Nepalese are not supplied through any of the financial actors presented above. The formal financial sector has largely failed to serve large parts of the national population, which would be essential to supporting economic development, job generation, and risk management. Cumbersome and long-winded, bureaucratic loan processes, inappropriate loan products, inflexible payment schemes, and collateral requirements makes the formal financial intermediaries unattractive or inaccessible for most loan-takers. In addition, Nepal's difficult topography, inadequate legal regulations, and a crisis in the state-owned commercial banking sector make it difficult for the financial intermediaries to serve the market. Liquidity, however, does not seem to be a problem for the banking system, also due to the deprived sector lending policy (see more on liquidity in the following chapter).[20] Although financial NGOs as well as cooperatives compensate to some extent for the lacking service provision by commercial financial intermediaries, they also do not sufficiently meet the needs of the poor and the rural population as well as the small and medium companies. Given that about 85 per cent of the national population lives in rural regions, the need to expand the access to services to those areas is obvious. With their broad network of branches, the state-owned commercial banks have an important role to play in the provision of financial infrastructure, but other players, including private commercial banks also have essential contributions to make.

One important example for the sluggishness of Nepal's financial sector is its poor reaction towards the increasing inflow of **remittances.** In the last two decades, remittances mostly from Nepalis migrating to India, the Gulf countries, and the Philippines gained dramatic importance for the national economy: Remittances are estimated to account for approximately 12 per cent of the GDP,[21] being by far the largest source of foreign currency earnings. The number of households receiving remittances has gone up massively over the last years, providing additional income to earnings primarily in the agriculture sector (Graner/Seddon 2004). Although awareness with regard to the importance of the remittance inflow is growing and although formal service provision has improved, about 70 per cent of the remittances still come into the country through informal channels. Many migrants, particularly those living in neighbouring India, simply carry funds in cash over the border or ask friends to do so. This was seemingly also the preferred mode to bring money into Nepal during the time of the violent conflict, although there is some evidence that migrants feared to lose their funds due to Maoist attacks on their way to their home villages (Bray et al. 2003: 122).[22] Yet, there was little momentum in the financial sector in Nepal to tap into the increased demand for formal remittance services. In fact, "remittances still can take from 10 days to several weeks to reach remote areas, and remitting through the formal sector is still expensive" (World Bank et al. 2006: 77). A sufficient network of efficient financial institutions is particularly important to harness the economic and development potentials of the funds transferred as efficiently as possible.

[20] There is however a problem with parked funds, which are not used for re-financing financial institutions.

[21] Given that informal transfers of remittances are high, actual figures are assumed to be higher.

[22] According to some reports, a proportion of the remittances was taken away by Maoists cells based abroad (Bray et al. 2003).

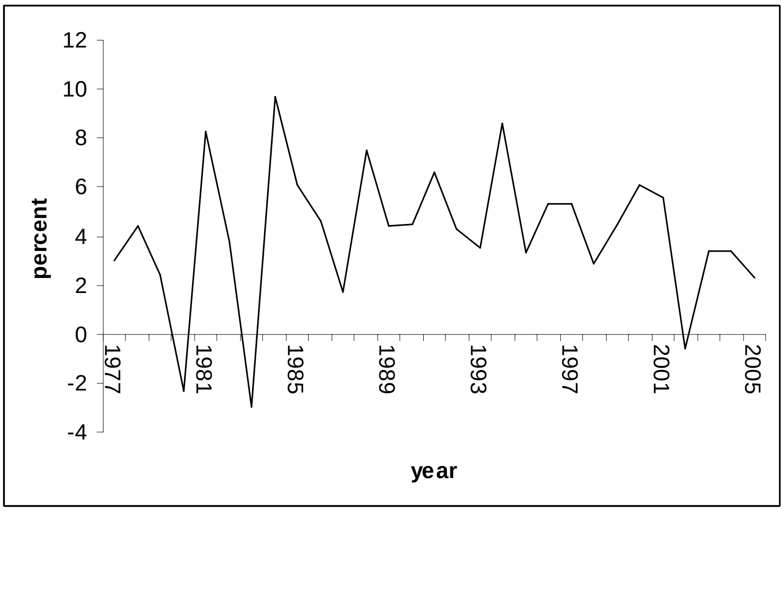
5 Economic effects of the violent conflict in Nepal

In the following chapter, the economic impacts of the violent conflicts in Nepal are discussed, first for the private sector in general, and secondly, for the financial sector in particular. Looking at the private sector in general provides important background information to better understand the needs for post-conflict peacebuilding, to assess the indirect impacts of the conflict on the financial sector and to be able to compare the effects that the conflict had on the financial sector with those in other economic sectors.

5.1 Economic conflict impacts and coping strategies of the private sector in general

Loss of lives, destruction of infrastructure, production facilities, and markets as well as many other direct and indirect consequences of violent conflicts destroy economic achievements and hamper future development (Cranna 1994; Debiel 1996; Collier 1998). The adverse effects of violent conflicts can vary significantly, depending on factors such as the intensity and duration of a conflict, its geographic spread, or the capacity of a country to adapt to the new situation (Fitzgerald/Stewart 1997; Stewart et al. 1997; Stewart et al. 2001). To accurately assess the economic costs of a conflict is difficult if not impossible, but estimations - some made with more sophisticated methods than others - are made for many conflicts. For Nepal, the annual loss of GDP during the conflict period is assumed to be between two and eight per cent. Graph 1 shows that GDP growth rates dropped from 5.6 per cent to minus 0.6 per cent in the year 2002, when the people's war intensified massively. Also in the years after 2002, GDP growth rates remained at a significantly lower average (about three per cent) than in the preceding decade (average about five per cent). In addition, private investment rates dropped from 15.4 per cent in 1996 to 12 per cent in 2004 (see for instance Dhakal/Sapkota 2004; FES 2005; Ra/Singh 2005; Seddon 2005) and exports fell drastically during the war period (Sharma 2004a).[23]

Graph 1: GDP growth rates in Nepal, 1977-2005



[23] However, the drop in exports cannot only be attributed to the violent conflict alone but is also an effect of the end of quota systems and preferential trade agreements in the context of the WTO accession of Nepal.

Costs inflicted by the destruction of infrastructure, such as telecommunication centres, power supplies, bridges etc. are assumed to be between USD 250 million and USD 900 million. A WFP / OCHA assessment of the impact of the conflict found that in 37 districts 1,143 cases of infrastructural damage were reported, including the destruction of agricultural service centres, airport towers, banks or cooperatives, bridges, drinking water facilities, health posts, police and army posts, post offices, roads, schools, telephone facilities, temples, industrial buildings, and governmental buildings (apart from Village Development Committee buildings) (WFP/OCHA 2007).[24] At the same time, development related expenditure went down, while security related expenditure went up.[25]

The regions most severely affected by the conflict were rural areas and districts located in the Far and Mid-Western hill and mountain regions. The WFP / OCHA study estimated that about 55 per cent of the districts were highly or severely affected, while only about eight per cent were not significantly affected.

Despite these negative figures, revealing detrimental conflict impacts for the national economy, Nepal can report positive developments with regard to the fight against poverty. The incidence of poverty fell drastically from 42 per cent in 1995/96 to 31 per cent in 2003/04. It is widely assumed that the **massive increase in remittance** from three per cent of GDP in 1995/96 to about 12 per cent in 2003/04 was a key factor for this positive trend. In fact, the World Bank suggested that a third to a half of "the overall reduction in headcount poverty rate" is due to the increase in remittances (World Bank et al. 2006).[26] Although labour migration occurred already before the violent conflict escalated, it increased in the conflict years, probably as a consequence of declining income opportunities.

Reliable information on the **impact of the conflict on the private business sector** is even more rare than macro-economic data and largely based on anecdotal evidence. The majority of the violence during the conflict happened between the Maoist armed forces and the national police and army. But private businesses as well as moneylenders and large landowners were also direct targets of the Maoists. From the early stages of the rebel movement, Maoists attacked multinational and large national corporations, such as Unilever Nepal, Surya Tobacco Company, Colgate Palmolive, Coca Cola, and several distilleries. Private companies were considered class enemies in the struggle of the leftists insurgency movement and as closely affiliated with the traditional elites (see also previous chapters) (Seddon/Hussein 2002; Thapa 2003).

Demands for 'voluntary' contributions for the Maoists were also common for nearly all companies in the country, including small companies and big business houses, sometimes inflicting serious costs on firms. Some argue that extortion and **'donations'** from businesses became the biggest source of income for the Maoist insurgency (Dhakal/Subedi 2006). A Nepalese weekly magazine, for instance, reports:

> "The extortion [on the East-West highway] takes different forms, such as forced 'voluntary' contributions of Rs 100,000 to support Maoist 'cultural events', protection rackets,

[24] The study was realized in 37 of the poorest districts in Nepal. Conflict was most severe in these regions, but allowance must also be given to the fact that due to the low level of development in these districts, they also belong to those districts with the lowest endowment of infrastructure facilities.

[25] Some donors suspended development assistance although most of the major projects and programmes continued to be implemented.

[26] Some qualifications have yet to be made. First, the poverty fell primarily in urban areas and significantly less in rural areas. Second, inequality also increased in this period of time, from a Gini coefficient of 34 to 41, being a result of a widening gap between the middle class and the rich.

> checkpoints, tollbooths, and 'taxation'. No businessperson we spoke to would dream of refusing, because they're faced with guns" (Nepal 2006).

Exact figures about the amounts of money paid in the form of "donations" are not known. Companies are secretive about the sums handed over to the insurgency, being worried about further extortions and fearing repercussions from the government, which does not allow for "the funding of terrorist movements".[27]

Other conflict related events, including frequent **road blockages and strikes** (or *bandhs* in Nepali), curfews and security checks further hampered business operations. Road blockages and strikes (together with the destruction of infrastructure) were a major impediment for all companies in the country. For instance, small producers in the agricultural sector, such as milk producers and small traders with only limited reserves are dependent on bringing their products to the market on time. Road blockages and strikes frequently impeded a timely delivery and inflicted losses and costs on producers as well as traders. According to estimates, a nation-wide strike can burden the economy with about Rs 630 million per day (approximately USD 10 million), not including the costs of Nepal's informal sector (Thapa 2003: 144). Only in February 2004, for instance, the International Crisis Group counted four major strikes between one and five days in the Kathmandu valley, illustrating the seriousness of the problem. *Bandhs* have remained a major problem primarily in the Terai area even after the signing of the CPA. For the period from January to August 2007 nearly all districts in the Terai counted between 36 and 90 strikes; in the Eastern parts of the Terai even between 73 and 90 (OCHA 2007b).

Closely related to the problems of strikes is the massive **increase in labour union activities** over the last years. Trade unions have only existed in Nepal since 1945 and mushroomed after the restoration of the multi-party democracy in 1990. Newly formed unions began to gain ground also in the private commercial banking sector, which had relatively few labour unions in the past. Most trade unions are closely aligned to political parties and are heavily divided among each other according to their political affiliations. In the view of many, unions in fact tend to act more for the interests of their political mother parties than for the workers' interests (interview, Nepalese expert, Kathmandu, 1 Oct 2007; Nepali Times 2007a). Concerns are raised that radical unions - frequently those considered affiliated to the Maoists - are used "to target the manufacturing sector, hotels, restaurants, and private schools" (Gaunle 2007) and to push through political agendas. Still, union groups on the level of individual firms often do not comply with the decisions made at the central-level of the union, further complicating the trade union landscape. Although the challenges related to labour unions are not a new and exclusively conflict-related phenomena, the politicisation of trade unions have grown in the last years. One interview partner illustrated the situation as follows:

> "I give you one example: In a small carpet firm with 35 employees there are six different labour unions, each with their president and vice president, each making promises to the staff and making ever higher demands on the companies in order to get more members into their union. How should you be able to work and produce under those conditions?" (interview, businessman, Kathmandu, 8 Oct 07).

Additional to the demands made by labour unions, private companies including banks increasingly face "ethnic requests". Particularly since the increase of ethnically-motivated unrest in the Terai, ethnic groups began to demand companies to employ a certain quota of ethnic minorities in their

[27] Companies were in part put in a difficult situation since they were on the one hand pressurized by the Maoists to pay "donations", but on the other hand the business sector was criticised by the government for funding the insurgency with their "donations" (interview, businessmen, Kathmandu, 27 Sep 07).

firms. Some companies seem to follow these pleas, but concerns are raised about the qualification of those employed on the basis of their ethnic identity and about a general trend towards lawlessness, fragmentation and "blackmailing". Groups, which make demands on the basis of ethnic or class reasons seem to thrive in Nepal. Given lacking law-enforcement, companies feel at mercy to these groups, which often make their claims violently or by threatening violence (interview, international expert, Kathmandu 5 Oct 2007).

Overall, the persistent high levels of insecurity and the inability to plan ahead has **undermined the business climate** in Nepal. Although the conflict did not threaten the existence of the private sector in general, it aggravated many of the structural economic challenges that the country faces. For example, the already weak competitiveness of many products "made in Nepal" was further undermined by conflict-related difficulties to deliver products on time, due to road-blockages, strikes, destruction of infrastructure etc. Some companies may have benefited from the conflict, such as airlines, "because - despite of the cost - people would rather travel by air for safety reasons" (Jyoti et al. 2006: 15). But overall, conflict-profiteers seem relatively rare. After the CPA was passed at the end of November 2006, companies temporarily expected improvements in their economic prospects. The flaring up of violence in the South shortly afterwards undermined this hope. Negative sentiments and a pessimistic outlook on the future are wide-spread, making companies - including foreign ones - reluctant to invest (interviews, businessmen, Nepal, 24 Sep to 8 Oct 2007).

Companies responded to the conflict-related obstructions and costs with different measures. Common **coping strategies** included the temporary or permanent closure of production facilities, capital flights as well as tightened security measures. Some companies are also reported to have relocated their business operations to neighbouring India. Particularly firms located in the Terai region or firms in Indian ownership that primarily served the Indian market and only came to Nepal due to governmental incentives, have transferred their activities across the border. Individual companies and business associations (such as the Federation of Nepalese Chambers of Commerce and Industries) also entered into direct negations with Maoists. They negotiated the amounts of "donations" with the Maoists (interviews, businessmen, Nepal, 24 Sep to 8 Oct 2007) or, such as in the case of Pokahara, one of the main tourism hubs in the country, they agreed "to exempt tourism from their [Maoist] activities" (Dhakal/Subedi 2006: 421). In a rare occasion in March 2007, the business community responded to the persisting levels of insecurity with a three-day strike, protesting against the continued Maoist depredations and demanding from the government to take the concerns of the business community more seriously (Nepali Times 2007b).[28]

In some cases, companies also improved working conditions in their firms when they realized that Maoists as well as trade unions managed to successfully mobilise followers based on the denunciation of bad labour standards. Large parts of the private sector in Nepal have a poor history of respecting labour laws, paying fair wages or implementing corporate social responsibility measures. Repeated unrest in firms (such as in brick-factories) ignited by labour unions or Maoists, impelled factory owners to introduce better conditions for workers, also for their own sake. In fact, there is some indication that companies providing decent working conditions were less frequently targeted by Maoists, than companies with poor conditions for workers (Dhakal/Subedi 2006).[29] Although many companies may still only pay lip-service to the importance of better conditions for workers, first steps have been made in some enterprises (interviews, int. experts, 2 and 5 Oct 2007).

[28] The strike was triggered by the beating of a hotel-owner by Maoists in Kathmandu who declined to pay a donation to the Maoists.

[29] Other factors that seem to make companies more vulnerable to Maoist assaults were their national origin (Indian and other foreign firms were more frequently targeted than Nepalese companies); if they were known tax-evaders; and if they employed non-locals in their companies (interviews, businessmen, Kathmandu, 30 Sep and 5 Oct 2007; Dhakal/Subedi 2006).

One of the most high profile endeavours of the business sector with respect to the violent conflict and peace process in Nepal was the establishment of the "National Business Initiative for Peace" (NBI). Inspired by a national conference on the "Role of the Private Sector in Peacebuilding, Reconciliation and Development" in which Nepalese businesspeople could learn from the experiences of South African business representatives in the transition period in their country, the NBI was founded in 2005. Today, 17 business associations are members of the NBI, including the Federation of Nepalese Chambers of Commerce and Industries (FNCCI); the Hotel Association Nepal (HAN); the Federation of Women Entrepreneurs' Association of Nepal (FWEAN); the Private and Boarding Schools' Organization of Nepal (PABSON); and the Federation of Nepalese Cottage and Small Industries (FNCSI). The goal of the organisation is to

> "contribute to the larger peacebuilding project of the country through just socio-economic growth. [...] The NBI is initiated to demonstrate the private sector's stake in the conflict and its commitment to peace. [...] We [the NBI] aim to redefine the image and role of he business sector in society as a crucial civil society actor capable of contributing to sustainable peace. We want to contribute to peacebuilding through practice of CSR (Corporate Social Responsibility) and by investing in socio-economic development of the country." (http://www.nbinepal.org.np) (For more detailed information see also Jyoti et al. 2006).

Despite the noteworthiness of the NBI, the initiative is facing some severe **challenges:**

First, although the NBI initially found broad approval in the business community, the incipient enthusiasm could not be maintained. NBI largely lives from the outstanding support of one leading business man, but did not manage to generate sufficient clout among other members of the national business community.

Secondly, while the NBI has decent access to representatives of Nepalese political parties, it struggles to establish channels of communications to the Maoists.

Thirdly, the NBI is struggling to establish itself as an authority or important player among civil society organisations with regard to the peace process in Nepal. The business community is traditionally observed with suspicion by civil-society organisations in Nepal, given the corporate sector's reputation of being politically opportunistic and as being a traditional supporter of the king. Business associations, for instance are presumed to mostly stand for the traditional business houses and the economic elite and not for the younger generation of entrepreneurs that may have had a more open attitude towards the peace process. In fact, the private sector is by many observers considered one of the weaker groups in Nepal (interview with Nepalese and international experts, Kathmandu, 1, 2, and 8 Oct 2007). Private businesses appear to be opportunistic with respect to their party alliances and are often entangled in corruption. One interview-partner described the private sector's behaviour as "political prostitution", giving the example that companies first supported the king when he took power but changed their views and turned to the popular democracy movement when the king became weak (interview with Nepalese expert, Kathmandu, 1 Oct 2007). Moreover, the Nepalese business community is strongly divided along ethnic lines, between the Marwaris with an Indian origin and the Newars with a Tibeto-Burman background. The two dominant ethnic groups are partly represented in different corporate interests groups, viewing each other with suspicion and undermining the cohesion of the private sector (interview with international expert, Kathmandu, 2 Oct 2007 and Dhakal/Subedi 2006). Overall, there seems little sense of unified action or unified position among the private sector, deteriorating trust of civil society groups in the business community.

Fourthly, one important sector of the business community, the financial sector, remained absent from the NBI. Despite being invited to join the NBI, the financial sector (e.g. the Bankers Association) decided not to become a member. Main reasons for this were the assumed political nature of NBI's activities and the concern of being brought into a difficult position with regard to some of the banks' clients. Indeed, many of those affiliated to the NBI are clients of banks, some of them being serious defaulters and in a long-term quarrel with the financial institutions. The financial sector participation in the NBI would also have been important since the financial sector has a distinctive position within the corporate community in Nepal. Although most local civil society organisations may not differentiate in this way, but international observers point out that the private financial sector (not the governmental financial sector) is overall less entangled in the omni-present traditional elite structures than most other economic branches. Most of the senior management in private banks is internationally trained and keeps up relatively high professional standards (interviews, international experts, Kathmandu, 5 Oct 2007).

Overall, most interview partners were sceptical about NBI's bearing on the peace process. Some member organisations criticised NBI's receding dynamism and the lack of concrete guidance on how companies can best respond to the challenges related to the peace process. The NBI is currently considering revising its membership structure and increasing its manpower in order to better respond to the needs of its members (interviews, businessmen, Nepal, 24 Sep to 8 Oct 2007).

5.2 Effects of the violent conflict on the financial sector

The Nepalese banking sector was a prime target of the insurgency during the violent conflict (see for instance Wehnert/Shakya 2003; Dhakal/Kanel 2004). Already in the 40-point memorandum from 1996, the Communist Party of Nepal (Maoists) (CPN (M)) stated that "Poor farmers should be exempt from loan repayments. Loans taken by small farmers from the Agricultural Development Bank should be written off. Appropriate provisions should be made to provide loans for small farmers."[30] During the violent conflict, financial institutions were part of the political and mobilisation strategy of the insurgency as well as a target of frequent attacks and extortions. Indeed, one of the first violent assaults by the Maoists was directed against a financial institution. On 13 February 1996 - the day when the rebels officially declared the "People's War" - 300 Maoists vandalised a farmers development bank in the Gorkha district in the West of the country, setting fire to files and documents (reported in Rajamohan n.d.). Besides these direct attacks, financial actors experienced a wide range of indirect conflict-related impacts, mostly - but not exclusively - negative for the financial sector.

Looking at the financial sector in Nepal in more detail, it becomes clear that the consequences of the conflict have varied significantly between different types of financial institutions. While state-owned commercial banks experienced in part grave losses, private commercial banks were considerably less badly hit. In the following section, the consequences of the conflict on microfinance institutions, state-owned commercial banks and private commercial banks will be discussed and their coping strategies will be presented. The reasons for selecting these three categories of financial service providers are their relevance for the financial service market in Nepal and the fact that the consequences of the conflict seem to be most varied between these three types of institutions.

[30] See the website of the South Asia Intelligence Review: http://www.satp.org/satporgtp/countries/nepal/document/papers/40points.htm. Accessed 13 October 2008.

Together with the previous chapter on the financial sector in Nepal, this chapter should help to better understand the structure, as well as old and new challenges for financial service provision in the country and should furthermore be the foundation for assessing the potentials and challenges of integrating the financial sector in peacebuilding.

Microfinance institutions

The violent conflict in Nepal took a toll - in some cases a heavy toll - on microfinance institutions (MFIs). While MFIs felt the conflict since its beginning in 1996, most interviewees stated that only since 2001 has the conflict brought about more significant economic effects. In the same way as other financial institutions or the business sector in general, MFIs experienced a wide set of different direct and indirect effects from the violent conflict, but the severity of the impediments varied significantly between different MFIs. In comparison to the other parts of the financial sector in the country, considerably more is written about how the conflict impacted ones. Partly, this may be due to the generally bigger attention that is paid to the role of MFIs in post-conflict peacebuilding, but it may also be an indicator for how pressing the conflict-related problems of MFIs are. Based on these existing studies as well as own interviews, the following main direct and indirect effects of the conflict on MFIs can be summarized:

Direct effects:

- Frequent **attacks and threats against premises of MFIs**. Attacks typically included the looting of MFIs, arson, or the destruction of buildings and equipment as well as documents and records. The Small Farmer Cooperatives, for instance, counted that about 50 out of about 125 branches were attacked during the conflict (Shrestha 2007). One interview partner estimated at least 500 cases of attacks countrywide. Attacks happened often at the time when instalments were collected and when more cash was available (interview, Nepalese microfinance expert, Kathmandu, 26 Sep 07).
- the **payment of "donations"** to Maoists;
- coerced **drop of interest rates**, when Maoists considered the interest rates charged by MFIs as too high and demanded a reduction.[31] Interest rates in MFIs are typically high. However, it is widely agreed that given the elevated transaction costs, greater risks etc. the high interests rates in MFIs are justified and necessary to assure sustainability;
- **undermining of trust**, which is essential for MFIs;
- **restriction of MFI staff's mobility,** when infrastructure such as bridges and roads were destroyed or blocked or when the security situation was not allowing for MFI staff to visit clients. In fact, some interview partners reported that MFIs did not have contact with their clients for over 5 years (interview, Nepalese microfinance expert, Kathmandu, 2 Oct 07).

[31] In some communities that were controlled by the Maoists, the rebels attempted to replace banks with their own institutions, giving higher interest rates on deposits and charging less on loans (Sharma 2004b: 46). Most of these institutions were presumably not sustainable.

The most common **indirect effects** of the conflicts included:

- **declining financial performance**;[32]
- **declining portfolio quality**[33] and in some cases increasing number of non-performing loans. This was partly due to households and small enterprises not being able to pay back loans, since they were economically distressed by the violent conflict. In some cases, customers also perceived the destruction of loan records by Maoists as a free ticket for not having to pay back loans, or followed the Maoists' encouragement not to pay back loans. Statements from interview partners were rather contradictory with regard to drop-out rates. While some informants claimed that drop-out rates did not increase, others reported a significant increase in drop-out rates (interviews with microfinance experts, Nepal, 24 Sep to 5 Oct);
- **higher operating costs** for MFIs, due to increased security expenditure and because fix costs stayed the same while business activities declined;
- **stagnating or shrinking outreach** due to a slow down or decline in the number of (new) branches or clients;
- some cooperatives did **not increase loan cycles** since members were reluctant to ask for bigger loans;
- in some cases, **insurances cancelled coverage** when increasing numbers of losses were reported.

The majority of MFIs were somehow impacted by the conflict, but interviews suggest that variations between MFIs were pronounced. Differences in the severity of the conflict-impacts were partly shaped by factors hard to influence by MFIs but were also influenced by MFIs' ability to actively cope with conflict-impacts. Factors such as the MFI's geographic location, for instance, influenced if an institution was more prone to attacks than other MFIs. Moreover, Maoists had overall a selective strategy with respect to the institutions and businesses they targeted. MFIs, which were considered to be associated with the Nepalese government (such as the Small-Farmer Cooperatives Limited - SFCL) were more frequently vandalized by the insurgency than MFIs that were considered independent (interviews, microfinance experts, Nepal, 25 Sep to 8 Oct). Similarly, those MFIs that were assumed to be funded by foreign governments, such as the USA, were more often attacked as the Maoists held an antagonistic attitude towards foreign donor engagement, particularly by those governments perceived as ideological enemies. In contrast, saving and credit cooperatives that were run by communities were less frequently attacked by the Maoists (interviews, microfinance experts, Kathmandu, 25 Sep, 2 Oct 07).

MFIs also applied a wide range of **coping mechanisms** in order to actively mitigate the negative consequences of the violent conflict. The most important strategies included:

---

32 Financial performance is typically measured with several indicators including the following: average performing assets; the return on performing assets, measuring the financial productivity of credit services and investment activities; operating cost ratio; operating self-sufficiency ratio, measuring whether a MFI has earned sufficient revenues to cover its cost; or the financial self-sufficiency ratio, measuring if a MFI earns enough revenues to cover the operating, financial and loan loss expenses while maintaining the value of their equity and quasi-equity relative to inflation.

33 Indicators measuring the portfolio quality include the portfolio at risk ratio, measuring the amount of default risk in the loan portfolio of a MFI; and the loan loss reserve ratio, measuring the percentage of loan loss reserves which is set aside to cover potential default loans.

- (Temporary) **closure of branches** in insecure regions or **relocation** of branches to safer places such as district headquarters;
- no further or **restricted opening of new branches**, specifically in the regions most severely affected by the violent conflict;
- **copying documents / records** and keeping them in safe places in order to quickly resume MFI work in case of destruction of files;
- **changing routes** of MFI staff when visiting clients in order to make them a less easy target for rebels;
- **reducing the amount of cash** being held on MFI premises and/or being carried around by MFI-staff when visiting clients in order to diminish losses in the event of an attack;
- **raising awareness** about the nature of MFIs' work. This included direct and indirect talks with the Maoists on the local level, press conferences and the setting up of signboards. The goal was to convince rebels of the positive, pro-poor character of MFIs. In some cases, MFIs had to prove to the insurgency that they are not associated to the Nepalese (such as in the case of SFCLs) or foreign governments. Many interview partners gave accounts of cases where clients spoke up for "their" MFI, not wanting to lose the institution that served them well. Although high-ranking Maoists arguably ordered attacks on financial infrastructure, some Maoists on the local level just "pretended" to target financial institutions in order to "follow" their superior's order and to comply with, at the same time, the local population's plea (interviews, microfinance experts, Nepal, 25 Sep to 2 Oct 07).
- establishing or **increasing insurance** coverage;
- **reduction of the volume of cycled loans** in cooperatives. Cooperatives normally aim to grant higher loans with every new loan cycle;
- **improving MFIs' performance** with regard to transparency, serving the poor, inclusion of women and minority groups etc. There is some indication that Maoists attacked more often those MFIs, which allegedly were badly managed or which worked in an untransparent manner. A GTZ report, for instance, stated: "It is reported that they [the Maoists] are rather tolerant of NGOs and local organisations which are conducted in a transparent manner and which deliver pro-poor results" (Wehnert/Shakya 2003). By improving their performance with regard to transparency, management, better services for the poor, women etc., the MFIs sought to reduce their risks of being targeted by the insurgency. In addition, clients and members of well-functioning MFIs were overall more willing to defend the MFI against the Maoists than clients of badly managed MFIs;
- setting up **conflict-sensitivity trainings.** SFCLs reported that some of the cooperatives unintentionally discriminated against women, Dalits and other disenfranchised groups, thereby contributing to the causes underlying the conflict. In specific trainings, cooperatives learned about how to become more conflict-sensitive and how to actively include more women and Dalits. In many cases, the training did not only improve the cooperatives performance and reduce their vulnerability to become a conflict target (see above), but also made them actively contribute to peacebuilding on a community level (interview, microfinance expert, Kathmandu, 2 Oct 2007);
- **diversify products.** Some MFIs made loan products more flexible, e.g. for those clients struggling to pay back in time. In this manner, re-payment rates increased again, which had declined when the conflict started.

Most of the interviewees from the microfinance sector judged that the conflict impacts, particularly security risks, threats and attacks, impaired their performance but did not fundamentally jeopardise their operations. Indeed, although the microfinance sector was distressed by the conflict, the **development of the sector was not fully stopped.** The growth in the number of branches slowed down and the financial performance, portfolio quality and operating efficiency was negatively affected in many MFIs, though clearly not in all (Dhakal/Kanel 2004). Hofmann and

Grossmann found that "despite the bleak situation in Nepal, the loan and deposit portfolios of several MFIs and SFCLs remained stable or even grew during the conflict period" (Hofmann/Grossmann 2005: 6). Similarly, the Asian Development Bank pointed out that in the period 1996 to 2005 the "farmers' and microenterprises' demand for financial services has not waned" (ADB 2006: 5). One reason for this phenomenon may be that commercial banks have become even more reluctant to lend money in rural areas and focus on urban consumer lending and housing finance only. Several interview partners, indeed, stated that the conflict offered new opportunities for the microfinance sector, since the retreat of other financial institutions particularly from rural areas provided the chance to expand networks. In addition, the conflict impelled MFIs to be more creative in the development of new products and to be more sensitive about their social impacts and performance.

Governmental commercial banks

Governmental commercial banks are the financial institutions **most severely distressed** by the violent conflict in Nepal. They were a frequent target of Maoist attacks since the beginning of the civil war. Looting, extortion of donations, bomb threats, destruction of bank premises and records belonged to the most common forms of antagonism that governmental commercial banks experienced. Requests for donations already began in 1996 but increased in the years 2001/2002, when the Maoist movement grew. One bank, for instance reported 31 cases of attacks against its branches and a loss of cash and valuable goods in the amount of approximately Rs 165 million (approximately USD 2.5 million). Another bank counted 153 cases of vandalism in their 540 branches.

The reasons for the large number of attacks against state banks is based on the Maoists' insurgency strategy as well as on the fact that state banks have a big network of branches in rural areas. The conflict in Nepal mostly took place outside the cities. Banks with a branch network in rural areas were, for this reason, an obvious target. The Maoists used the attacks against governmental banks also as part of their battle against the Nepalese state. Weakening the state banks was seen as tantamount to weakening governmental structures. Maoists, for instance, called on the people not to pay back their loans (see above). It should also be remembered that already in the 40-point-memorandum from 1996, the state Agriculture Development Bank was explicitly mentioned and it was demanded to exempt poor farmers from repaying their loans. Widespread misuse in state banks and bad services for the poor ideologically justified the attacks - additionally, of course, to the obvious need to fund the Maoist movement.

The fact that these banks were mostly government-owned, limited the bank's options for **coping strategies**. The Maoists had proven to occasionally take up a pragmatic stance towards which specific institutions were targeted. As described above, MFIs (and to some extent also private commercial banks) had direct contact to the Maoists to negotiate and to thereby reduce the likelihood of being targeted. Being state-owned, this was less of an option for governmental banks. Some interview partners, however, suggested that state banks had, in some cases, better relations to the army and police to provide security, but information on this matter was rather vague (interviews, bank representatives, Nepal, 30 Sep to 4 Oct 2007).

As a consequence of the conflict, costs increased in banks, partly because security and insurance costs were raised, but also because staff costs swelled. One bank reported, for example, that for some vulnerable branch offices, the number of security guards was tripled from originally 20 to 60.34 In some cases, incentives had to be paid to staff members so that they would work in bank offices in conflict zones; in other cases, staff could not be laid off and had to be paid even after a branch was closed. One interview partner estimated that operation costs increased by almost 25 per cent (interview, bank official, Kathmandu, 26 Sep 2007). However, some banks increased security measures only slightly and faced a less sharp increase in security expenditure. In addition, while state commercial banks were already plagued by a large number of non-performing loans before the conflict broke out, the number of clients that was not able or not willing to pay back their loans increased slightly in many governmental banks during the conflict. One bank, for instance, stated that the number of bad loans increased by four per cent during the conflict period, partly because nearly 6.000 of their clients were murdered, disabled or displaced during the conflict (interview, bank official, Kathmandu, 1 Oct 2007).

The severity of the problem that the state banks faced is probably most apparent when looking at the number of **branches that were closed** over the last years. One state commercial bank reported to have closed or merged with other branches (such as in safer district headquarters) about 100 offices from formerly 230 - more than 40 per cent. Another bank shut down or merged about 30 per cent of its offices throughout the country. (Graph 3 gives an overview of the development of private and governmental commercial bank branches in Nepal). This development also became apparent on a national level, with a "decline in outreach by formal financial institutions" (World Bank et al. 2006: 76). Yet, while many of these closures or mergers may have been an immediate consequence of the conflict, some have to be seen in the context of the general crises of the state commercial banks. Many of the branches, which were shut down during the conflict, were economically unviable even before the insurgency began, struggling with overstaffing, bad management, insufficient numbers of clients etc. The violent conflict in this sense had a "cleansing effect", driving out unsustainable banks and making space for better suited financial institutions. For the governmental commercial banks, this had the positive effect that they could then focus on more lucrative markets, typically in urban areas. In addition to the mixed reasons for the closure of banks, was also the increase in "bad loans" only partly a result of the economic impacts of the conflict. Many defaulters "free-rode" on the conflict, using the economic consequences of the civil war as a pretext for not paying back their loans.

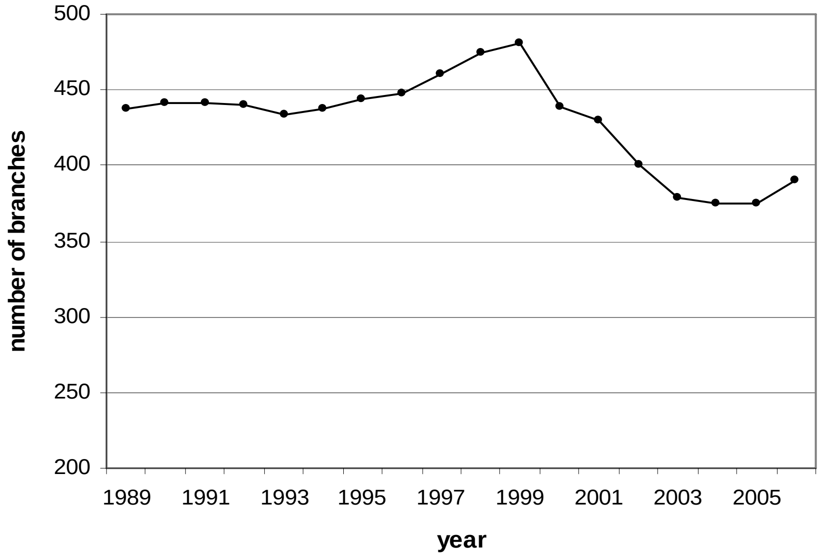
Since the formal ending of the conflict in November 2006, banks have initiated activities to help their **recovery process**. Although the still instable environment made it difficult to fully resume business in large parts of the country in the period after the signing of the peace agreement, banks have taken up a range of measures to deal with the impacts of the conflict. Among others, banks tried to recuperate records that were lost or destroyed during the conflict. During the conflict, most banks assumed a policy of keeping (electronic) copies of documents in safe places, similar to the practice also used by MFIs, but many documents were nevertheless destroyed. The recovery process has turned out to be slow and cumbersome as there were repeated cases of clients presenting false credit or account statements. Some banks have set up special committees that work on the restoration of records and decide on the authenticity of the claims made. Also in those cases where looted funds were insured, the recovery of the money has not yet been completed, given the substantive bureaucratic process that is required (interviews, bank officials, Nepal, 26 Sep to 3 Oct 2007). Some banks also re-opened branches that were closed during the conflict period, but mostly

[34] An increase in security did not always help as Maoists continued to attack banks, ostensibly in order to get into the possession of the security guards' weapons.

it has been decided not to re-open all branches, since not all were viable. For example, one bank that had to close down 100 branches is planning on only re-opening a quarter to a third of its offices.[35]

Governmental commercial banks also began to restructure and reschedule loans, waive penalties, give discount interests etc. for those clients, who were hard hit by the conflict and who are struggling to pay back their loans. The decisions on how loans can be restructured and rescheduled are made on a case by case basis, but in most banks a general policy is in place to guide this process. A limit to these recovery packages is the central bank policy that requires loan takers to pay back at least 25 per cent of the interest (interviews, bank officials, Nepal, 26 Sep to 3 Oct 2007).

Graph 2: Number of commercial bank branches in Nepal



Source: Nepal Rastra Bank (2006). Quarterly Economic Bulletin, Volume XXXX, Mid-July 2006, Number 4.

Private commercial banks

Private commercial banks belong to the financial institutions least severely affected by the civil war in Nepal. In fact, private commercial banks could generate good operating profits during the conflict period. Given the strong impacts of the conflict on governmental private banks, the comparatively modest consequences for the private banks are remarkable.[36] The main reason for the mild impacts is the geographic concentration of private commercial banks in the Kathmandu valley and their scant presence in rural regions where most of the conflict took place. Yet, we will also see later that the

[35] Nepal Rastra Bank allows banks which were closed down during the conflict to be opened again without extra formal permission. Moreover, although the minimum capital requirement was doubled in the new lending policy, those banks in very remote areas where other financial institutions are not operating, the minimum capital requirement is still lower, leading to more development banks opening in these regions.

[36] Allowance must be given to the fact that those interviewed outside the Kathmandu valley expressed a little more concern about the impacts of the conflict on their operations than interview partners located in the Kathmandu valley.

banks managed to successfully adapt to the new environment and could effectively harness from new economic developments.[37]

Only few of the private banks that were interviewed for this study reported to have experienced direct **attacks.** Assaults occurred, but relatively rarely. One bank representative, for instance, reported that a cash collecting vehicle was attacked; other bankers stated that their non-banking assets, such as factories in the ownership of the bank, were a target of Maoist assaults; or bankers mentioned insular attacks against their premises. Most private banks, however, experienced repeated **threats** by Maoists or groups pretending to be Maoists, demanding "donations". These harassments were widely perceived as intimidating for staff and management. Some interviewees, in fact, pointed out to difficulties in keeping good staff since many employees decided to move away, looking for a safer and more stable work environment (interviews, bank officials, Nepal, 24 Sep to 5 Oct 2007).[38]

Conditions improved slightly in 2006, but not to the extent most bankers had hoped for. In June 2006, for instance, the Nepalese Bankers Association expressed its "serious concern" over the rising number of robberies and lootings of financial institutions. Despite the ceasefire agreement, a climate of lawlessness due to often criminally motivated violence persisted and made banks a frequent victim (BBC News 2006). Also, the increasing turbulences in the South took their toll on bankers. In addition, to general insecurities, an organisation called the "Association of Loan Affected People" was founded in the Terai about two years ago. Similar to the Maoists, the association encouraged people not to pay back their loans, blaming banks for exploiting the people. Although they have not inflicted severe damage so far, movements such as the "Association of Loan Affected People" increase insecurity for banks and further undermine the business climate.

Different banks applied very different **coping strategies** to deal with the immediate effects of the conflict. Some increased their security expenditures by hiring more security personnel. Other banks found this not to be an effective solution since the rebels attack financial institutions in very big groups. Some private banks reduced cash held in branches, installed CCTV cameras, recording facilities for threat calls or held regular consultations with intelligence services. One bank outside the Kathmandu valley also reported that in response to the bad security conditions on roads, they used helicopters instead of cars to transport money. Insurance coverage existed in most banks as a standard policy before the conflict broke out (interviews, bank officials, Kathmandu 24 Sep to 5 Oct 2007). A number of banks also negotiated with the rebels, some directly, others with the support of a mediator. Besides these measures that individual banks undertook, the Banker Association lobbied with the government for more security when threats against private banks increased. But most bankers interviewed considered the government as, overall, not very supportive. Remarkably and as already mentioned above, the financial sector did not join the National Business Initiative for Peace (NBI) as a way to lobby for peace. The official reasons given were the politically sensitive nature of NBI's work in which the banking sector did not want to get involved in as well as the risk of a conflict of interest, since many of NBI's members are highly-indebted clients of financial institutions. Some observers, however, interpreted the absence of the financial sector in the NBI also as a result of the moderate economic impact that the violent conflict had on this sector, reducing the incentive to participate in the group.

[37] Capital flight, especially to India occurred but was not a massive problem.

[38] In 2002, the government ordered to freeze bank accounts, which presumably belonged to Maoists (BBC News 2002). The policy was part of the government's strategy to weaken the Maoists. Private commercial banks unanimously declared that they were not affected by this policy (interviews, bank officials, Kathmandu 24 Sep to 5 Oct 2007).

Depending on the coping strategies adapted by the individual banks, **costs** for security measures increased to different extents. One private bank reported to have experienced an increase in security costs by about 30 to 40 per cent. Costs were also inflicted on banks because staff had to be paid incentives for working in less secure branch offices. Little information is available on how much money was paid in "donations" to Maoists or groups claiming to be Maoists. The private banks themselves argue that they paid nothing or very little. Since paying to terrorist groups was prohibited and given the strict legal requirements for banks for transparent book-keeping, they argued simply not to be in a position to pay out "donations". Yet, it has been reported that branch managers paid donations out of "their own pocket" or that money was collected among staff (interview, bank officials, Nepal, 3 and 4 Oct 2007). It is likely that banks found some way to compensate staff members and branch managers for their expenses when they had to pay "donations".

Banks closed only few branches as a result of the difficult security situation. One interview partner in fact argued that more banks, primarily joint-venture banks, would have left if the consequences of the conflict would have been more severe (interview, bank official, Kathmandu, 27 Sep 2007). The seldom closure of branch offices also has to be understood against the background of the thin branch network of private commercial banks outside the Kathmandu valley. Many observers, moreover, speculated that most of the branches that were closed were originally only opened to comply with the banking rule to establish branches outside the Kathmandu valley for branches opened in the valley. The bad security situation was used only as a pretext to close these anyhow unwanted offices.

Additional to the relatively mild direct impacts of the conflict on the banking sector, indirect impacts also remained relatively modest. Nearly all private bankers interviewed for the report stated that they experienced losses due to the slow down in the economy and that medium and long-term profit targets were not met. Plans to expand branch networks also had to be postponed since security was bad and since economic prospects were not considered sufficiently positive for venturing into branches outside the Kathmandu valley. One bank, for instance, reported that they had intended to open up nine new branches in rural and more remote areas of the country, following a strategy to have offices in all districts. But the conflict thwarted these plans. Similar claims were made by nearly all private bank officials interviewed.

Losses, stagnations and decline was experienced primarily in investment banking, structural loans, and in corporate products. Banks became, for instance, very reluctant to give loans to the severely conflict-affected tourism sector and private companies grew ever more careful in realising investments, given the volatile political and security situation. Yet, private commercial banks were largely successful in **compensating for the loss in corporate banking by a noteworthy growth in retail banking.** Retail banking and consumer lending were the main sources of profits for the private financial sector over the last years. Some of the banks changed their business operations quite drastically in order to respond to this new trend. Banks, for instance, with an original focus on corporate clients increased their retail business by 30 to 50 per cent in the last decade. An increase in housing loans, loans for motor-cycles, cars or televisions strongly shaped the banks' businesses. High liquidity in the country, lack of investment options, interest rates below inflation rates, and drastic urbanisation leading to a growing demand for housing were the main factors driving the increasing demand for retail lending. Moreover, for the banks, retail banking is much less risky than corporate loans and clearly the preferred option in the difficult political and security environment. The high level of liquidity available in the country, is assumed to be mainly a result of the growing inflow of remittances. Some also argue that increasing barter trade with Tibet, money coming in from NGOs and international organisations, as well as a growing middle-class are factors contributing to the high liquidity (Dahal et al. 2000; Nepali Times 2003).

The positive developments in most private commercial banks and its sharp contrast to the pitiful situation of most governmental banks caused - in the view of some bankers - a wide-spread sense of jealousy. One interview partner said that "the private banks are seen as the new moneylenders." In fact, the reputation of the private banks seems to have suffered during the conflict period for a number of reasons, among others, due to the politicised debate about the restructuring of loans. During the conflict and after the signing of the CPA in 2006, private banks, similar to their governmental peers, were repeatedly asked by the business community to restructure loans, wave penalties etc. in order to assist conflict-hit companies in their recovery process. Many businesses felt that the banks did not sufficiently respond to their needs. Or as one businessman put it: "Even during the time of the curfews,[39] when companies could not operate for weeks, banks requested loan payments as usual." The banking sector, on the other side, considered many of the demands made by the companies as exaggerated. On a case-by-case basis they restructured loans for troubled businesses, but they feared that many firms would use the violent conflict as an excuse for not paying back their advances and as the beginning of a rising number of non-performing loans. The matter developed into a sensitive politicised issue in which also private businesses tried to get the government on their side, demanding from the state to support them in getting better terms on their loans and credits from banks.

The resilience of private commercial banks in Nepal amidst conflict seems to have facilitated another interesting development that became slowly apparent since the end of 2006 and which is crucial also with respect to post-conflict reconstruction. The signing of the CPA in November 2006 gave impetus among private commercial banks to re-consider their plans to **expand branch networks in Nepal, specifically outside Kathmandu**. This development is remarkable, particularly since private banks were, in the past, frequently criticised for being overly risk-averse, insufficiently creative and for not looking enough at the rural areas of Nepal as a market for their services (interviews, international and local experts and governmental officials, Kathmandu, 24 Sep to 5 Oct 2007). Incipient plans to expand the branch network were halted during the time of the conflict, given the insecure environment. But by 2006, expectations were high that the security situation and political conditions would be stable enough to allow for the opening of new offices as well as for the offering of new products, particularly suited for the more remote and rural areas. Some interview partners form commercial banks, for instance, planned on offering agricultural loans or similar products and some began to slowly open up new offices in areas outside the Kathmandu valley, remarkably including remote regions. Nearly all of the interview partners from private commercial banks, in fact stated that they were at some stage of planning or realising investments in more remote regions. During the time of the research, it was, however, not possible to find clear statistical information supporting these claims. Available statistics did not, for instance, differentiate between private commercial banks and state commercial banks. According to the statistics, there were altogether 375 branches in 2004 and 2005, signifying the years with the lowest number of bank branches in Nepal. By mid 2006, the numbers had risen again to 390 branches (Nepal Rastra Bank 2006). According to interview partners, most of the growth in fact happened in the Hill areas and the Terai region and due to commercial private banks. However, it was not possible to confirm this with the available statistical data.

[39] King Gyanendra established a new cabinet beginning of 2004, given heavy protests by political parties, students and civil society organisations against the lack of democracy. But the king dismissed the government some months later, assumed power and began to control the country under the state of emergency. Central constitutional rights were suspended, activists and political critics were arrested, and communication facilities between Nepal and the world were largely closed down.

Interview partners gave four main reasons for their new interest in expanding their businesses to more remote regions:

- the considerable inflow of remittances allows for new business opportunities outside the valley;
- the competition between banks and other financial institutions in the Kathmandu valley is growing rapidly, encouraging banks to look for new markets in other geographic regions;
- with the opening of the Nepalese market in 2010 to foreign financial service providers in the context of Nepal's accession to the WTO, Nepalese banks will be exposed to even more competition. They want to tap into the national market before foreign competitors can do so;
- the good financial conditions most private banks are in, allows them to venture into new markets.

But the developments after November 2006 with continued political crises and newly flaring up violence largely frustrated the banks' expansion plans (interviews, bank officials and government representatives, Kathmandu, 24 Sep to 5 Oct 2007). Although the political instabilities slowed down private financial institutions in exploring these markets, the interest is noteworthy, particularly given the retreat of governmental banks from rural regions in the context of the conflict.

6 “Financial peacebuilding” - contributions by the private sector

The financial sector is assumed to have a catalyst role in advancing economic development. Looking from a peacebuilding perspective, this role can be especially beneficial in peacebuilding efforts when poverty and unequal development are at the root of the conflict. Contributing to poverty reduction can be crucial for sustainable conflict transformation and in preventing countries from relapsing into war. Also with regard to more general and immediate post-conflict and reconstruction needs, financial sector actors may be able to assist, such as by providing funds for infrastructure rebuilding or supporting loan-mechanisms to IDPs, returning to their homes. For some of these options of engagement, it may be possible to create - under specific circumstances - direct **win-win arguments,** such as for the expansion of financial infrastructure. For others, such as providing loans or even grants to IDPs, the bank’s motivation needs to be **social responsibility**, with a long-term view on the (stability, reputational and economic) returns on its engagement.

It is often argued that financial institutions are particularly dependent on a stable and safe working environment. They are reluctant to invest in countries where banking regulations are weak and where political and security conditions are volatile. Yet, it seems to be necessary to distinguish between different types of financial intermediaries. Experiences made with microfinance institutions in conflict and post-conflict contexts, for instance, seem to suggest that MFIs are less reliant on a stable political and legal environment than originally thought. Similar to MFIs, local banks may also have a particular role to play when it comes to operating in conflict contexts. They are “already there”, are more familiar with the terrain, and feel arguably more responsible for the place than foreign financial actors. **Local financial institutions** - if they endured the conflict - could therefore play an important role in supporting peacebuilding and bridging the period between the formal ending of a conflict and the beginning of investments by international banks.

The main goal of the research is to look specifically at the role of this local financial sector (primarily private banks) and to explore for the case of Nepal, how the conflict impacted these institutions, how they responded to the conflict and what the potentials and limits for their engagement in peacebuilding may be. In spite of the conflict, a relatively healthy private financial sector exists in Nepal, side by side ailing governmental financial institutions and a plethora of partly effective, partly ineffective microfinance organisations. The conflict primarily hit the governmental banks and some of the microfinance institutions. The local private commercial banks only experienced comparatively mild effects as a result of the conflict. These findings suggest that the local commercial banks could assume a particular role in peacebuilding in Nepal. Most of the banks are presumably financially healthy enough to support peacebuilding activities and private commercial banks recently showed interest in going to more rural areas, which may provide options for combining their business interest with peacebuilding goals. But overall, the (private) financial sector has hardly considered concrete ways of how to support conflict transformation and the establishment of a sustainable, peaceful environment.

In the following paragraphs, the information provided in the previous chapters is analysed and further discussed in order to get a better understanding on the limits and potentials of financial sector engagement in peacebuilding.

Conflict impacts on the financial sector and coping strategies

Already before the violent conflict broke out in Nepal in 1996, the financial sector landscape was characterised by insufficient remittance transfer services as well as lacking financial services for the rural population and for small and medium companies. In addition, a high number of default loans, bad management, inadequate regulations and supervision brought the financial sector in Nepal close to a collapse. The decade long conflict between the Maoists and the government further troubled the financial sector, but had severe effects only on some actors and in some regards. The conflict did not lead to a complete break down of the financial infrastructure, as was reported from other countries, such as Sierra Leone or Somalia. It much rather - like some other guerrilla wars - only brought about partial distress. In fact, a number of **positive developments** occurred during the conflict period, potentially helping the financial sector to evolve. Informal moneylenders, for example, who were mostly active in rural regions, charged exorbitant interest rates and led loan-takers into a situation of structural dependence - were expelled from their villages in large numbers. Similarly, some of the weaker microfinance institutions and banks were cast out from rural regions. The conflict also, rather awkwardly, boosted (labour) migration, thereby increasing remittances inflow and hence liquidity, which turned out to be a facilitating factor for the growing retail business of private commercial banks, which again helped them to endure the conflict period quite profitably.

On the negative side, the civil war inflicted significant **costs for financial institutions**, primarily for governmental banks, but also to MFIs and private commercial banks. It undermined trust, threw back plans to expand branch networks, and reduced lending to the corporate sector. The retreat of (state) banks from rural areas, inflicted by the substantial assaults against governmental banks, diminished the financial infrastructure in these regions and strengthened informal lending, mostly from family and friends.[40] Some people in remote and more instable regions could not be served for a long period of time by their microfinance institutions due to security reasons.

The conflict seemingly also brought out some **fundamental discontent of the population with the financial sector** or may have even worsened the financial sector's reputation. Scandals surrounding politically motivated lending and default loans had undermined the trust of the general population in the financial sector already before the conflict erupted. The financial sector - primarily the mismanaged state banks - was largely seen as part and parcel of the crony elite system. The insurgency directly capitalised on these deficiencies. In fact, ideologically, the attacks against banks and the Maoists' encouragement not to pay back loans are not only part of their leftist economic convictions.[41] They also have to be understood as an element of their rebellion against the clientelist and feudal economic and political structures.[42] The private commercial banks were not spared from a declining reputation. In contrast to the governmental banks, the private commercial banks were a comparatively rare target of Maoists' attacks, largely because of the small number of branch offices in the main conflict zones. While this geographic dimension may have saved private banks from some of the most severe direct impacts of the conflict, they still felt some of the indirect consequences of the conflict, such as declining reputation and diminishing trust. Private banks are, for example, looked upon with suspicion because of the large profits they generated in the last decade despite the overall economic downturn. The politicised debate about their lack of willingness to help troubled businesses by restructuring loans placed them also in a bad light. The perception of the private banks as the "new moneylenders" is of distinct explosiveness in the anti-feudal political discourse that grew during the conflict. Although the private banks may be one of the sectors in Nepal least entangled with the ubiquitous cronyism, given their professionally trained management, the banks are perceived in the current political contexts and predominantly social and economic templates as part of the traditional system. Groups such as the recently established "Association of Loan Affected People", which seemingly copied the Maoists' demands and took advantage of the general lawlessness in the country, may be another indication for the dissatisfaction of the

---

40 The expanding informal lending was also made possible by the big liquidity in the country.

41 Maoists, of course, also needed to generate funds for the movement.

42 The fact that the insurgency also targeting micro-finance institutions with a clear pro-poor mission seems to suggest that little differentiation was made between the various financial players and that MFIs' operating principles were not always understood (e.g. with regard to high interest rates). Only when MFIs, supported by the (rural) population set out their mandates and intentions, MFIs were in part spared from attacks.

population with the financial system. But it also shows the sector's vulnerability towards allegedly socially motivated claims and illustrates the fact that in a conflict environment no player can stay neutral, even if the private banks see themselves largely distant from the conflict.

It is highly problematic to assess how the financial sector in Nepal would have developed without the emergence of the civil war. From the information collected for this study, it can be assumed that the purging of inefficient (state) banks in rural areas would not have been as pronounced as without the conflict. But it can be assumed that more private financial institutions would have opened new branches in rural areas. As stated above, private banks entertained the plan to expand into areas outside the Kathmandu valley for some time, but had to hold off because of the insecure environment. Whether many of the structural problems of the financial sector would have been more effectively addressed in a peaceful environment, is impossible to answer. The conflict seemingly aggravated some of the fundamental deficiencies, such as the provision of financial infrastructure. Others, however, such as the lack of lending to SMEs or insufficient transfer mechanisms for remittances remained largely unchanged by the conflict.

Peacebuilding tasks

Focusing on private commercial banks (while also including governmental commercial banks and microfinance institutions in order to get a more comprehensive picture of the financial sector landscape), the findings from the study suggest that private commercial banks have a potentially constructive role to play in peacebuilding. A number of reasons and specific fields of engagement can be identified:

- The remarkable **economic profitability** that they sustained despite the conflict. Private commercial banks stood out with respect to how they were impacted by the conflict and how they managed to continue to generate profits. Banks, particularly governmental banks that were severely hit by the conflict and were already in "bad health" before the conflict emerged, may struggle to allocate necessary resources for peacebuilding-oriented activities. The private commercial banks seem to be in a much better economic position to assist in peacebuilding. Their relative economic prosperity also stands in sharp contrast to many of the cases, which so far have been discussed in the literature (e.g. Somalia, Afghanistan) and where the commercial financial sector was nearly fully depleted.
- It could be argued that private commercial banks may not have enough incentive to support peacebuilding, simply because they did not "sufficiently" feel the negative impacts of the conflict. Yet, private banks also stated that they fell behind their economic medium and long-term targets because of the conflict and that a peaceful environment was overall more conducive for them than war. Moreover, those banks that opened new branches in regions outside the Kathmandu valley, may have a particular interest not to lose their new investments because of up-flaring violence.
- The violent conflict in Nepal had a positive "cleansing effect" on the financial sector landscape. This together with issues, such as the increased need for formal remittance services offers **new market opportunities** for formal commercial financial actors.
- **International banks** are not very likely to come to Nepal soon. Given the relatively small Nepalese market, the continuously volatile political situation as well as restrictions on foreign ownership of banks, it is doubtful that foreign banks will enter Nepal in big numbers in the near future. The opening of the financial market in 2010 in the context of Nepal's WTO accession may bring some momentum into the financial landscape, but whether that is sufficient to attract foreign investments remains to be seen. For this reason, local banks have a particular role to

play with regard to "financial peacebuilding". They are familiar with the political conditions and the market in order to assume some of the peacebuilding tasks, which so far have only been discussed for international banks.

- Private financial institutions do not seem to be entangled in **cronyism** in the same way as most other economic actors. For this reason, they may have less to lose from a "new social and political dynamic" than the traditional feudal elite and may be more open to overcome the traditional social frameworks, as is aimed for in the political and social peacebuilding process. In fact, interview partners frequently ascribed a **high level of professionalism** to the private commercial banks. It is known from other peace processes such as in Guatemala, that the structural inter-dependence of the traditional economic elite with the status quo, often makes these economic actors an unreliable partner for peacebuilding (Joras 2007). The presumably rather rare entanglement of private commercial bankers with the traditional economic elite, may make them a particularly interesting player for peacebuilding in Nepal.

A structural way of how financial institutions could assist in peacebuilding, is by contributing to a better provision of financial service infrastructure in Nepal. As stated before, financial services are widely assumed to have a direct impact on poverty reduction. As poverty was a central cause for the emergence of the violent conflict in Nepal, supporting to reduce the root causes of poverty and unequal development may be one of the most effective **contributions of the financial sector to peacebuilding.** Additional to these structural ways of assisting sustainable peacebuilding, there are a range of activities that could be directed towards the more immediate reconstruction needs. Activities could include:

- **improved financial service provision** for the poor population, especially in the **rural and more remote areas**, such as by broadening the network of branches;
- offering **agricultural loans in rural areas** and other financial products, which better suit the needs of the population;
- support **loan-mechanisms for IDPs** returning to their homes. No detailed figures are available on the number of people uprooted by the conflict in Nepal. The most widely circulated figures estimate that there are between 100,000 and 200,000 IDPs, but only a small number is officially registered (OCHA 2006; OCHA 2007a). Although it is commonly assumed that since April 2006, thousands of IDPs have returned to their homes (on their own steam or supported by NGOs), the majority of IDPs still do not dare to return. One of the reasons why people are reluctant to go back is, apart from the instable security situation, also the lacking opportunities to make a living in their home villages and towns (OCHA 2006).[43]
- **supporting MFIs** through capacity building and by refinancing;
- **improved lending for SMEs**;
- provide **assistance to conflict-hit companies** by restructuring loans or offering seed-money to adequate conditions;
- enhance **long-term lending,** such as for infrastructure projects;
- offering more and **better services for the transfer of remittances** and developing products to effectively use diaspora funding for development. An option would be to analyse the informal remittance services and try to establish connections;

---

[43] Although the government has plans for support packages, payable to returnees, the project has not been realised as of yet. Of those people who left their homes, it is probably the subsistence farmers who are most in need for support, but overall knowledge on the needs of the people is still scant. Among the IDPs there are also many landowners, moneylenders and other village elite who left their homes due to threats from Maoists. In fact some interview partners also assumed that those wealthy IDPs had little reason to return to their original homes. Many fled to Kathmandu, buying houses in the valley and building a new life.

- introduce **conflict-sensitivity** screenings and measures into financial service provision in order to assure that the benefits of financial services are maximised and the detriments minimised.

While most of these activities listed above address issues that were identified as shortcomings of the financial sector long before the violent conflict erupted, others only emerged as a reaction to the conflict. Further, of those shortcomings that existed prior to the conflict, the need to address them increased in relevance and urgency with the emergence of the conflict. With the destruction of infrastructure facilities, for instance, during the course of the conflict, there was a bigger need for long-term financial resources for reconstruction efforts. Similarly, the increase of remittance inflow during the conflict made the provision of effective transfer services more pertinent. Other issues, however, stayed largely unchanged during the conflict. Many of the reasons why the (private) financial sector has not yet tapped into the un-served markets are related to hindrances that have existed in the same or similar way as they did before the conflict. Low population density, difficult geographic conditions or insufficient legal regulations form and formed severe impediments for accessing these markets and may continue to deter private banks' engagement in these regions. Similarly, problems such as frequently changing political scenarios that make it difficult to plan ahead will almost certainly be problematic in the next years. In fact, looking at a number of publications on the financial sector in Nepal, there is a widespread agreement that large parts of the financial market are not profitable for private commercial banks. The ADB concluded, for example:

> „A high risk rural finance profile, repressive policy environment, and security concerns in rural areas make private sector participation in RF [rural finance] extremely difficult. Difficult terrain and topography inhibits rapid deployment of private institutional RF services on a larger scale. Wider sector reform is required to address the policy and institutional bottlenecks to growth and development of efficient and sustainable RF services for the poor" (ADB 2006).

Contrary to this assessment, it is remarkable that since the end of the conflict, private banks showed unprecedented interest in opening up new offices in areas that they largely ignored in the past. Sometimes these new offices are "only" located in district headquarters; other times, however, they are based in astonishingly remote regions. It is, however, important to understand that the motives for entering into these fields are not founded on the desire to support peacebuilding. Much rather, this development is driven by economic rationales, including new market potentials due to the inflow of remittances and increased competition in their traditional urban markets. Yet, it should be remembered that the private commercial sector was frequently criticised for not being creative enough or willing to tap into the market outside the Kathmandu valley. It is much too early to judge the potential of this relatively new development and to assess if this is in fact a new trend that will grow over the next years or not. The swelling attraction that the markets outside the Kathmandu valley seem to have for the local private banks, could well hold the potential for a fruitful win-win situation, in which the banks expand into new markets and thereby assist in poverty reduction and peacebuilding.[44] But at the time when the field-work was undertaken, there was little indication that the government realised any concrete policy measures to support the banks in their "expansion" endeavours. Given that since the peace talks in 2006, economic topics were largely submerged into political topics, this does not come as a big surprise. In addition, it has to be taken into consideration that the relationship between the private financial sector and the government is per se strained and shaped by mutual suspicion. State assistance to private commercial banks to enforce their expansion (e.g. with tax breaks) may be an appropriate mechanism to support economic

[44] Private banks have also recently pledged money for infrastructure investments. The fund is not explicitly directed towards reconstruction efforts but requires a longer-term commitment of the private banks.

peacebuilding. MFIs may to some extent have closed the gap that the shut down of state bank branches left in rural regions, but it is obvious that there is still demand for more formal financial services.

While win-win situations, as described above, may be pivotal to encourage private business actors to support peacebuilding endeavours, **corporate social responsibility** and **philanthropy** are also important driving forces. Governmental banks do not currently seem to be in a condition to pay much attention to corporate social responsibility, since - as one interviewee stated - "we have other things to do at the moment; we have to restructure this bank first." Other governmental bankers pointed out that with their mandate to support development in Nepal, they already respond to corporate responsibility demands (interview, bank official, Kathmandu, 26 Sep 2007). Private commercial banks have, so far, failed to pay much attention to CSR or social investments. A number of private banks advertise their corporate responsibility engagements on their websites, but they predominately consist of unstructured charities and ambiguous CSR frameworks. Typically, they include financial support to an occasional cultural or sport event as well as assistance to health or education projects. In general, CSR seems to remain something that is sporadically added on to their normal operations, with little strategic importance. It is largely dealt with at the level of the headquarters, with hardly any awareness about CSR on the level of branch offices. Many also seem to think that the mandatory contribution of four per cent to deprived sectors sufficiently fulfils their CSR engagement or use it as an excuse for not developing their own CSR policies (interviews, bank officials, Kathmandu, 25 Sep to 2 Oct 2007). In view of the poor response of private banks to the deprived sector lending regulation, this argument does not convince. Also the Bankers' Association does not encourage its members to develop CSR frameworks. Its absence from the Nepal Business Initiative for Peace (NBI), where it would have had a chance to engage in CSR issues, seems to underline this position.[45]

The limited commitment to CSR and social investments sheds a bad light on the private financial sector, specifically because they are one of the few economic players in Nepal that came out well after the war. Moreover, it should be noticed that there is a tradition of social welfare in Nepal, such as in the concept of "Guthi", which encourages people to contribute to society (see for example Save the Children 2007). There seems to be little understanding about the benefits of CSR work in the financial sector. In some other economic branches, such as in brick factories, the importance of CSR was somewhat increased as a result of the conflict. Targeted assaults by Maoists or intensified labour union action forced these companies, which often held a reputation of exploiting their work-force, to improve their labour practices.[46] Private financial institutions, which were less frequently directly targeted by unions or Maoist attacks had little incentive to change their outlook on CSR. Also when financial institutions rejected demands made on them to more actively engage in social activities and financial sector development, this remained largely without any direct repercussion.

For the private commercial banking sector immediate benefits of CSR measures have rarely been tangible. The more indirect effects that the violent conflict had on them, such as the general economic downturn or reputational losses also did not succeed in propelling CSR-activities. But the World Bank Country Director writes, for instance, in a newspaper article:

---

[45] Reluctance of the private sector to participate in peace-supporting initiatives such as the NBI on the grounds of the Maoists' business-hostile comments and policy suggestions (for example opting for a planned economy) would have been justifiable. However, in interviewees repeatedly claimed that the business sector did not fear a radical left turn of the government or the introduction of policies that opposed corporate interests in the context of the peace process. The main reason for this may be that the Maoists had publicly expressed more business-friendly views, since the beginning of the peace talks. Another reason could be the long-standing tradition of leftist parties in Nepal that made companies being "used to" coping with radical left-leaning demands.

[46] Labour exploitation can also be a cause for conflict - or a justification for it. In Nepal, Maoist rebels used allegations against companies for exploiting workers as a reason for their movement.

> "[…] at this particular moment, when there is a huge clash of two sharply opposing ideas about how to manage Nepal's economy, I would hope that the members of the banking community will see that they should think beyond the immediate impact on their profit and loss statements. Without social responsibility, a market system can break down. Today, thinking about how to make the banking system friendlier to the small and medium businesses and the poor Nepalis more generally, in my view, is what social responsibility demands" (Ohashi 2006).

A good opportunity to show that the banks are interested in assisting the country in its pressing needs would have been in the context of the debate around restructuring loans. Although it is difficult to assess who was right given the politicised manner in which the debate was led - the loan-takers claimed that the banks did not sufficiently help them in restructuring loans, or the banks who argued that the subject was instrumentalised and used as a pretext for willful defaulters - a more transparent or perhaps a more generous way of responding to the private companies' request for concessions could have raised the banks' social profile.[47]

As indicated above, closely linked to the subject of CSR is the issue of **conflict-sensitivity.** In the general debate on the role of the financial sector in violent conflicts, the subject of conflict-sensitivity was so far mostly understood in the context of international banks trying to avoid business relations with potentates involved in violent conflict (Know-Your-Customer-Policies etc.). This dimension seems to be of minor importance for the Nepal case since there is little evidence that Nepal developed into a conflict-economy where those concerns are of particular relevance. The findings from Nepal suggest, however, that there is a need for financial institutions to look at conflict-sensitivity on a more local level. Not only large-scale infrastructure projects, which attracted most attention in the past, have to be viewed through a conflict-sensitivity lens but also the every day smaller-scale business operations. The example of MFIs in Nepal that successfully adopted conflict-sensitive approaches by developing more adequate products and more actively integrating disenfranchised groups, illustrates the relevance of conflict-sensitivity for financial sector operations. Financial institutions should make an effort to explore the social, environmental and conflict impacts of their businesses, examining, for instance, if they directly or indirectly discriminate against certain caste, ethnic or gender groups. Such an approach is not only necessary to avoid sustaining or perpetuating a conflict but also as a coping strategy. The MFI-example shows that those institutions, which enjoyed legitimacy in their community, were less frequently targeted by rebel-groups and were, in fact, actively defended against Maoists' assaults. Those with a bad track-record or reputation, in contrast, were a more frequent target.

In general, supporting peacebuilding does not have to imply that financial institutions lose their profitability. It is also not intended that they become altruistic organisations, losing sight of their economic goals. But it can be argued that the private commercial banking sector in Nepal has neither fully understood not fully explored its options to better contribute to a more peaceful environment. Bankers interviewed for this report unanimously agreed that the violent conflict in Nepal was largely driven by poverty and exclusion and that the financial sector has a role to play in reducing poverty. But so far little concrete steps were taken to actually practice what they preach. The Bankers Association could play a vital role in encouraging their members to consider joint CSR-activities or programmes, but has so far not seen its role in this field. Peacebuilding or conflict management seem to be perceived as subjects distant from the banks daily operations. They see it

[47] Many companies and business associations requested the government to provide seed money for troubled businesses, such as in the form of loans. The government in fact has a programme for sick industries. But according to interview partners, the money has so far gone largely to big industries, primarily in the tourism sector with hardly any funds reaching other sectors, cottage industries or medium sized companies (interview, businessmen and representatives of business associations, Kathmandu, 24 Sep to 8 Oct 2007).

as a political matter, as events whose effects could largely be dealt with by increasing security measures. Little awareness exists on how banks may influence the conflict setting, in a positive or negative way. The banks seem, in fact, to struggle to fully comprehend what is expected from them with regard to social or peacebuilding engagements. More awareness about conflict issues and more creativity and courage would be needed before financial actors may be prepared to engage actively in peacebuilding. So far, hardly any concrete peacebuilding ideas have been discussed within the financial community. Yet, in many interviews it was suggested that if one organisation would take the lead, many would follow suit.

7 Summary findings and recommendations

Impacts of the conflict

1. The violent conflict in Nepal had mixed effects on the different financial sector actors in the country. Private commercial financial actors have only been mildly affected by the conflict; microfinance institutions experienced moderate effects and governmental commercial banks were in part severely impacted by the sustained violence. In comparison to what is known on the state of private commercial financial sectors in other countries coming out of conflict, the Nepalese sector is relatively healthy and should, for this reason, have the essential economic flexibility to use resources in support of national peacebuilding efforts.

2. The variation in the consequences of the conflict for the different financial sector actors resulted from factors such as the geographic location of the financial institutions, the applied coping strategies or if the financial actor was perceived as an ideological target by the insurgency. The private commercial financial sector was a rare target of insurgency attacks and they applied successful strategies to minimise the negative economic effects of the conflict.

3. While the conflict did not lead to a break down of the financial system in Nepal, it led to partial distress and aggravated some of the main deficiencies of the national financial sector. Yet, the civil war also had a "cleansing effect" on the financial sector landscape, creating spaces for new forms of financial sector activities and reforms.

Peacebuilding-assistance

4. The private financial banks in Nepal may be able to play an important role in peacebuilding, among others because they were not as severely affected by the conflict as other economic actors. In addition, most local commercial financial actors seem to be managed professionally, with relatively little entanglement in the pervasive cronyism of the country. This may make commercial financial actors more receptive for changes in the socio-economic status quo of the country.

5. The comparatively weak economic impacts of the conflict on private commercial financial actors may, however, undermine their willingness to support peacebuilding, given a lack of economic incentives. Peacebuilding is, in fact, a distant subject to the private financial sector. They have little understanding of what their role may be in peacebuilding and reveal overall little propensity to support ongoing private sector activities in this field.

   Recommendation: *External encouragement and awareness-raising is required for the financial sector to see its interlinkages with conflict and peacebuilding and to increase their understanding of the economic long- and short-term benefits of peace for their own operations.*

6. A greater sense of social investment and corporate social responsibility (CSR) is important as a basis for financial sector actors to engage in peacebuilding. While economic win-win situations are of pivotal significance, an increased sense of social responsibility may be an important additional impetus to motivate companies to support peacebuilding.

   Recommendation: *The National Business Initiative for Peace (NBI) was in the vanguard to engage private sector actors in peacebuilding in Nepal, putting particular emphasis on the importance of corporate social responsibility. External national and international actors should strengthen the NBI and support its capacity to increase the awareness of the private business sector, including the financial sector, with regard to their social responsibility and their role in peacebuilding.*

7. Activities how financial actors, primarily private commercial financial actors could contribute to peacebuilding include:

   - Contribute to addressing the root causes of the conflict, such as by expanding the financial service infrastructure in the country, offer specifically developed services and products, geared towards the disenfranchised parts of the population and the predominant reconstruction needs.
   - Harness the increasing inflow of remittances by offering formal services so that remittances can be effectively used, also for the reconstruction of the country. Formal financial institutions have to think about creative ways of how to build on the existing informal remittance transfer system, learning from the experiences made in other conflict-affected countries where the remittance business was the "basis for rebuilding a new financial system on cessation of active conflict" (Maimbo 2007: 26).
   - Develop transparent policies for restructuring loans in order to efficiently assist conflict-affected companies to reconstruct their businesses.

   Recommendation: *The government and international community should support the commercial financial sector in developing and offering new products and services, which have a direct or indirect contribution to peacebuilding. The incipient trend of commercial financial actors to expand their business operations to more remote areas of the country should be actively supported, for instance by providing further incentives as well as technical assistance.*

8. Develop conflict-sensitivity guidelines for all financial institutions and particularly for those active or moving into rural and remote areas, such as microfinance institutions or private commercial banks which consider to invest in these regions.

   Recommendation: *International donors and the government should assist in developing conflict-sensitivity guidelines for the financial sector. It was, for instance, shown that some microfinance institutions, which have discriminated against certain disenfranchised population groups, have begun to approach this problem. Conflict sensitivity is also crucial against the backdrop of the need to create tangible peace-dividends for the war-affected population, and for those population groups which formed the main mobilisation basis of the insurgency - the poor, excluded and disenfranchised parts of the Nepalese population. It was also shown that those financial institutions which were well managed were less frequently targeted by the insurgency and more often protected by the clients.*

9. Microfinance institutions will continue to play a pivotal role in Nepal's peacebuilding and reconstruction process. The commercial financial sector will not be able to take up the market that is typically served by MFIs, such as in very remote areas. The "cleansing effect" that the conflict had for microfinance institutions may bring a new dynamic into the development process of this sector.

   Recommendation: *Continue to support MFIs given their relevance for post-conflict reconstruction.*

10. The ongoing financial sector reform has to continue to assure a long-term viability of the financial sector. Specifically, activities against defaulters are relevant in order to create trust between the population and the sector.

References

Adams, Brad (2005). "Nepal at the Precipice." *Foreign Affairs* 84(5): 121-134.

ADB (2006). Report and Recommendations of the President to the Board of Directors. Proposed Sector Development Program Cluster of Loans, Asian Development Fund Grant, and Technical Assistance Grant. Nepal: Rural Finance Sector Development Cluster Program, Asian Development Bank.

ADB (2007). Inequality in Asia. Key Indicators 2007. Special Chapter. Highlights. Manila, Asian Development Bank.

Addison, Tony (2002). "Conflict and Financial Reconstruction." *Finance and Development Briefing Papers,* March.

Addison, Tony/Geda, Alemayehu/Le Billon, Philippe, et al. (2005). "Reconstructing and Reforming the Financial System in Conflict and 'Post-Conflict' Economies." *Journal of Development Studies* 41(4): 703-718.

Addison, Tony/Geda, Alenayehu (2001). "Ethiopia's New Financial Sector and Its Regulation." *WIDER* Discussion Paper No. 2005(55).

Addison, Tony/Geda, Alenayehu/Le Billion, Philippe, et al. (2001a). "Financial Reconstruction in Conflict and 'Post-Conflict' Economies." *WIDER* Discussion Paper No. 2001(90).

Addison, Tony/Le Billion, Philippe/Murshed, Mansoob S. (2001b). "Finance in Conflict and Reconstruction." *WIDER* Discussion Paper No. 2001(44).

Anderson, Mary B. (1999). Do No Harm. How Aid Can Support Peace - or War. Boulder, Lyne Rienner.

Banfield, Jessica/Gündüz, Canan/Killik, Nick, Eds. (2006). Local Business, Local Peace: The Peacebuilding Potential of the Domestic Private Sector. London, International Alert.

Banktrack (2003). Good Faith, Good Practice. Implementation and Accountability of the Equator Principles.

Banktrack (2006). Equator Principles Re-launched. http://www.banktrack.org/doc/File/policies%20and%20processes/Equator%20Principles/060706%20EP%20relaunched.doc. Accessed 13 October 2008.

Basyal, Tula Raj (2004). "Financial Sector Reform in Nepal." In: *Nepalese Economy. Towards Building a Strong Economic Nation-State*. Madan Kumar Dahal, Ed. Kathmandu, Central Department of Economics, Tribhuvan University and New Hira Books Enterprises: 53-80.

BBC News (2002). Nepal targets rebel finances. http://news.bbc.co.uk/1/hi/world/south_asia/1752929.stm. Accessed 13 October 2008.

BBC News (2006). Concern over Nepal bank robberies. http://news.bbc.co.uk/2/hi/south_asia/5037120.stm. Accessed 13 October 2008.

Bray, John (2004). MIGA's Experience in Conflict-affected Countries. The Case of Bosnia and Herzegovina. *Social Development Papers*. Paper No. 13, The World Bank.

Bray, John (2005). "International Companies and Post-Conflict Reconstruction. Cross-Sectoral Comparisons." *Social Development Papers* No. 22.

Bray, John (2006). Public-Private Partnerships in State-Building and Recovery from Conflict. *Briefing Papers ISP BP* 06/01, Chatham House.

Bray, John/Lunde, Leiv/Murshed, S. Mansoob (2003). "Nepal: Economic Drivers of the Maoist Insurgency." In: *The Political Economy of Armed Conflict. Beyond Greed and Grievance*. Karen Ballentine and Sherman, Jake, Eds. Boulder, Lynne Rienner: 107-132.

Bray, John/Switzer, Jason/Hussels, Mareike, et al. (2004). Investing in Stability. Conflict Risk, Environmental Challenges and the Bottom-Line. UNEP FI, iisd.

Bruett, Tillman (2004). Conflict and Post-Conflict Environments: Ten Short Lessons to Make Microfinance Work. The SEEP Network, Progress Note, No. 5.

BWTP (2004). Nepal Country Profile.

Center for Advanced Defense Studies (2006). Afghanistan's Business Environment: Investing in Uncertainty. Washington.

CGAP direct (2004). Supporting Microfinance in Conflict-Affected Areas. www.cgpdirect.org. Donor Brief 21.

Champain, Phil (2002). "Engaging the Private Sector in Conflict Transformation - an overview of possibilities and challenges." *CCTS Newsletter* 19(3): 9-17.

Collaborative Learning Projects (2003a). The Role of Business in Conflict Resolution and Peace Building. Issue Paper. http://www.cdainc.com/cdawww/pdf/issue/issue_paper_conflict_resolution_Pdf.pdf. Accessed 13 October 2008.

Collaborative Learning Projects (2003b). Social Investment Projects. Issue Paper. http://www.cdainc.com/cdawww/pdf/issue/cep_issue_paper_social_investment_projects_Pdf.pdf. Accessed 13 October 2008.

Collier, Paul (1998). "On the Economic Consequences of Civil War." *Oxford Economic Papers* 51: 168-183.

Collier, Paul/Elliott, Lani/Hegre, Havard, et al. (2003). Breaking the Conflict Trap. Civil War and Development Policy. Washington, The World Bank and Oxford University Press.

Cramer, Christopher (2005). Inequality and Conflict. A Review of an Age-Old Concern. UNRISD.

Cranna, Michael, Ed. (1994). The True Cost of Conflict. Seven Recent Wars and Their Effects on Society. New York.

Croft, Jane (2007). Costs rise in war on money laundering. Financial Times. 9 July 2007.

Crossin, Corene/Banfield, Jessie (2006). "Conflict and Project Finance: exploring options for better management of conflict risk." *International Alert* Background Paper.

Dahal, Madan Kumar, Ed. (2004). Nepalese Economy. Towards Building a Strong Economic Nation-State. Kathmandu, Central Department of Economics, Tribhuvan University and New Hira Books Enterprises.

Dahal, Rajendra/Adhikari, Achyut/Nepal, Kiran (2000). Money, money everywhere. Who says Nepal is a poor country? We are awash in cash. Nepali Times. 20 Sep - 26 Sep 2000.

Daniel, Tim (2004). "Repatriation of looted state assets: selected case studies and the UN Convention against Corruption." In: *Global Corruption Report* Transparency International, Ed. London, Pluto Press.

Debiel, Tobias (1996). Kriegswirtschaft und Friedenskonsolidierung. Erfahrungen und Herausforderungen in den Regionen des Südens. INEF-Report, Duisburg.

Deraniyagala, Sonali (2005). "The Political Economy of Civil Conflict in Nepal." *Oxford Development Studies* 33(1): 47-62.

Dhakal, Ameet/Sapkota, Bishnu, Eds. (2004). The Costs of War in Nepal: A Research Study. Kathmandu, National Peace Campaign.

Dhakal, Ameet/Subedi, Jhalak (2006). "The Nepalese private sector: Waking up to conflict." In: *Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector*. Jessica Banfield/Gündüz, Canan and Killik, Nick, Eds. London, International Alert.

Dhakal, Nara Hari (2007). Towards Expanding the Frontier of Microfinance Services in Nepal. International Conference on Rural Finance Research: Moving Results into Policies and Practice, FAO Headquarters, Rome, Italy. 19-21 March.

Dhakal, Nara Hari/Kanel, Jyoit Prasad (2004). Micro Finance Services in Insurgency and Conflict Situation: Case Study of Nepal. A study conducted for International Network of Alternative Financial Institutions (INAFI) Nepal and South Asia Partnership, Kathmandu, Nepal.

Duffield, Mark (2000). "Globalization, Transborder Trade, and War Economies." In: *Greed and Grievance. Economic Agendas in Civil Wars*. Mats Berdal and Malone, David M., Eds. Boulder, London, Lynne Rienner Publishers: 69-89.

EIRIS (2006). Project finance: a sustainable future? SEE risk briefing.

FES (2005). Cost of Armed Conflict in Nepal. Seminar organized by Nepal Foundation for Advances Studies.

Fitzgerald, E.V.K./Stewart, Frances (1997). "Editors' Introduction." *Oxford Development Studies* 25(1): 5-10.

Gaunle, Shiva (2007). Stop Press. Nepali Times. Issue 354; 22 June 2007 - 28 June 2007.

Geiser, Alexandra (2005). Social Exclusion and Conflict Transformation in Nepal: Women, Dalit and Ethnic Groups. swisspeace Working Paper. Berne.

Global Witness (1999). A Crude Awakening. The Role of the Oil and Banking Industries in Angola´s Civil War and the Plunder of State Assets. London.

Graner, Elivra/Seddon, David (2004). "Nepal's Remittance Economy: A Decade of Change (1996-97 to 2003-04)." In: *Nepalese Economy. Towards Building a Strong Economic Nation State*. Madan Kumar Dahal, Ed. Kathmandu, Central Department of Economics, Tribhuvan University and New Hira Books Enterprises: 29-54.

Haufler, Virginia (2001). "Is There a Role for Business in Conflict Management?" In: *Turbulent Peace. The Challenges of Managing International Conflict*. Chester A. Crocker/Hampson, Fen Osler and Aall, Pamela, Eds. Washington, D.C., United States Institute of Peace Press: 659-675.

Hofmann, Armin/Grossmann, Helmut (2005). Rural Finance in Conflict Environments - Experienced from Nepal's Small-Farmer Cooperatives Limited (SFCL), Gesellschaft für Technische Zusammenarbeit, GTZ.

Humphreys, Macartan (2003). Economies and Violent Conflict. Harvard College.

International Alert (2005). Conflict-Sensitive Business Practice: Guidance for Extractive Industries. London.

International Alert (2006). Conflict-Sensitive Project Finance: Better Lending Practice in Conflict-Prone States. London.

International Crisis Group (2005). Nepal's Maoists: Their Aims, Structure and Strategy. Asia Report No 104. Kathmandu, Brussels.

International Financial Services (2006). Banking. City Business Series. March 2006.

International Monetary Fund (2006). IMF Country Report Nepal. No. 06/407.

International Monetary Fund (2007). IMF Country Report Nepal. No. 07/366.

Joras, Ulrike (2007). Companies in Peace Processes. A Guatemalan Case Study. Bielefeld, transcript.

Jyoti, Padma/Rai, Hemlata/Hofmann, Armin, et al. (2006). Business for Peace: Nepali Private Sector Gets Involved in Conflict Transformation and Peace-Building. Strategy Paper. NBI National Business Initiative.

Kremer, Carsten (2004). Die FATF und der internationale Kampf gegen die Geldwäsche. REGEM Analysis No 10. Trier University.

Maimbo, Samuel Munzele (2007). "Remittances and financial sector development in conflict-affected countries." *Africagrowth Agenda* January-March: 26-29.

Maimbo, Samuel Munzele/Patel, Mayank/Mahler, Walter, et al. (2006). "Financial Sector Development in Somalia: Central Banking and Financial Services in an Uncertain Environment." In: *Remittances and Economic Development in Somalia. An Overview*. Samuel Munzele Maimbo, Ed. Washington, The World Bank. Social Development Papers, No 38: 38-51.

Mansley, Mark (2005). "Private Financial Actors and Corporate Responsibility in Conflict Zones." In: *Profiting from Peace. Managing the Resource Dimensions of Civil War*. Karen Ballentine and Nitschke, Heiko, Eds. Boulder, Lynne Rienner: 207-233.

Mierke, Axel (2006). Conflict Prevention and Peace Building. Elements of PSD/SED Programmes. GTZ. Eschborn.

Mills, Rob/Fan, Qimiao (2006). The Investment Climate in Post-Conflict Situations. WPS4055. Investment Climate Capacity Enhancement Program. The World Bank Institute. Washington DC.

Mishra, Chaitanya (2006). "Locating the "Structural Causes" of the Maoists Struggle." In: *The Maoist Insurgency in Nepal: A Monograph. Causes, Impact and Avenues of Resolution*. Shambhu Ram Simkhada and Fabio, Oliva, Eds. Geneva, HEI, PSIO: 19-61.

Murshed, Mansoob S./Gates, Scott (2005). "Spatial-Horizontal Inequality and the Maoist Insurgency in Nepal." *Review of Development Economics* 9(1): 121-134.

Nagarajan, Geetha/McNulty, Michael (2004). Microfinance Amid Conflict: Taking Stock of Available Literature, USAID, EGAT, AMAP.

Nelson, Jane/International Alert/Council on Economic Priorities, et al. (2000). The Business of Peace. The private sector as a partner in conflict prevention and resolution. London.

Nenova, Tatiana (2004). Private Sector Response to the Absence of Government Institutions in Somalia. World Bank.

Nenova, Tatiana/Harford, Tim (2004). Anarchy and Invention. How Does Somalia's Private Sector Cope without Government? The World Bank Group. Public Policy for the Private Sector. Note No 280.

Nepal, Kiran (2006). Non-government. Nepali Times. Issue 315:1

Nepal Rastra Bank (2006). Quarterly Economic Bulletin, Volume XXXX, Mid-July 2006, Number 4.

Nepali Times (2003). "Things are going to be in limbo again..." Issue 161, 5 - 11 September 2003. http://www.nepalitimes.com.np/issue/2003/2009/2005/Interview/4057. Accessed 13 November 2008.

Nepali Times (2007a). Labour reform. Issue 358, 20 July - 26 July 2007. http://www.nepalitimes.com.np/issue/2007/2007/2020/FromtheNepaliPress/13760. Accessed 13 November 2008.

Nepali Times (2007b). Victim turned aggressor. Issue 341, 23 March - 29 March 2007. http://www.nepalitimes.com.np/issue/2007/2003/2023/BizNews/13358. Accessed 13 November 2008.

nepalnews (2007). Maoists want democratic republic with mixed economy, radical land reform: Prachanda; http://www.nepalnews.com.np/archive/2007/feb/feb13/news12.php. Accessed 13 October 2008.

OCHA (2006). OCHA Nepal Thematic Report. The Internally Displaced Persons: Current Status. Issue No.1. Kathmandu.

OCHA (2007a). Inter-Agency Thematic Report. The Internally Displaced persons - Current Status. Issue No. 2. Kathmandu.

OCHA (2007b). Nepal: Reports of Bandhs / Blockades - 01 January 07 to 31 August 2007, http://www.un.org.np/reports/maps/OCHA/2007/2007-09-27-Bandhs-Blockades-Jan-1-to-Aug-31-2007.pdf. Accessed 13 October 2008.

Ohashi, Ken (2006). A challenge for bankers, a test for SPA. The Kathmandu Post. 13 September 2006.

Paffenholz, Thania (2006). Nepal: Staying Engaged in Conflict. Experiences and Lessons Learnt from Conflict Sensitive Programme Management (CSPM) in Fragile Context with Armed Conflict. Swiss Agency for Development and Cooperation - East Asia Division.

Ra, Sungsup/Singh, Bipul (2005). Measuring the Economic Costs of Conflict. The Effect of Declining Development Expenditures on Nepal's Economic Growth. Working Paper Series No.2, Asian Development Bank.

Rajamohan, P.G. (n.d.). Communist Party of Nepal (Maoist) - CPN (M). http://www.ipcs.org/agdb14-nepalmaoists.pdf. Accessed 13 October 2008.

Rice, Susan E./Graff, Corinne/Lewis, Janet (2006). Poverty and Civil War: What Policymakers Need to Know. Global Economy and Development Working Paper. The Brookings Institution. Washington DC.

Save the Children (2007). Corporate Social Responsibility and Children's Rights in South Asia. Kathmandu.

Scher, Daniel (2005). "Asset Recovery. Repatriating Africa's looted billions." *Africa Security Review* 14(4): 17-26.

Schwartz, Jordan/Hahn, Shelly/Bannon, Ian (2004). "The Private Sector's Role in the Provision of Infrastructure in Post-Conflict Countries. Patterns and Policy Options." *Social Development Papers* No. 16.

Seddon, David (2005). Armed Violence and Poverty in Nepal. A case study for the Armed Violence and Poverty Initiative. Centre for International Cooperation and Security. University of Bradford.

Seddon, David/Hussein, Karim (2002). The Consequences of Conflict: Livelihoods and Development in Nepal. Working Paper 185. Overseas Development Institute. London.

Sharma, Kishor (2004a). Economic Policy and Civil War in Nepal. Paper for the WIDER conference on Making Peace Work, 4-5 June, Helsinki.

Sharma, Shankar (2006). Defaulters jeopardizing reforms. The Kathmandu Post. 8 September 2006.

Sharma, Sudheer (2004b). "The Maoist Movement: An Evolutionary Perspective." In: *Himalayan 'People's War'*. Michael Hutt, Ed. London, Hurst & Company: 38-57.

Shrestha, Roshan (2007). Community Participation and Conflict Management: A Case of Small Farmer Co-operative Ltd. presented at the International Conference on Sustainable Development in Conflict Environment: Challenges and Opportunities, unpublished manuscript.

Singh, Navin (2004). Willing to go after defaulters. Nepali Times. Issue 227, 24 Dec - 30 Dec: 6.

Stewart, Frances (2004). "Horizontale Ungleichheit als Ursache von Bürgerkriegen." In: *Kriege als (Über)Lebenswelten. Schattenglobalisierung, Kriegsökonomien und Inseln der Zivilität*. Sabine Kurtenbach and Lock, Peter, Eds. Bonn, Dietz. 16: 122-141.

Stewart, Frances/Huang, Cindy/Wang, Michael (2001). "Internal Wars: An Empirical Overview of the Economic and Social Consequences." In: *War and Underdevelopment. Volume I: The Economic and Social Consequences of Conflict*. Frances Stewart and Valpy FitzGerald, Eds. Oxford, Oxford University Press: 67-103.

Stewart, Frances/Humphreys, Frank P./Lea, Nick (1997). "Civil Conflict in Developing Countries Over the Last Quarter of a Century: An Empirical Overview of Economic and Social Consequences." *Oxford Development Studies* 25(1): 11-41.

Swanson, Philip (2002). Fuelling Conflict. The Oil Industry and Armed Conflict. Fafo Institute for Applied Social Science.

Switzer, Jason/Hussels, Mareike (2004). "Investing in Stability and Sustainability - Conflict Risk, Environmental Challenges and the Bottom-Line." In: *Investing in Stability. Conflict Risk, Environmental Challenges and the Bottom-Line*. UNEP FI and iisd, Eds. Geneva, UNEP FI, iisd: 7-34.

Switzer, Jason/Ward, Halina (2004). Enabling Corporate Investment in Peace. An Assessment of Voluntary Initiatives Addressing Business and Violent Conflict, and a Framework for Policy Decision-making. Discussion Paper. Prepared for the Department of Foreign Affairs and International Trade. iied iisd. Chatelaine; London.

Taylor, Mark (2002). Preface. In: Winer, Jonathan M.: Illicit Finance and Global Conflict. Fafo-report.

Thapa, Deepak (2003). A Kingdom under Siege. Kathmandu, The Printhouse.

The Corporate Responsibility Coalition (2005). A Big Deal? Corporate Social Responsibility and the Finance Sector in Europe.

Tibrewala, Niranjan (2004). "Role of Private Sector in the Economic Development of Nepal." In: *Nepalese Economy. Towards Building a Strong Economic Nation-State*. Madan Kumar Dahal, Ed. Kathmandu, Central Department of Economics, Tribhuvan University and New Hira Books Enterprises: 287-310.

UN Wire (2000). Partnerships: Holbrooke Lauds Business Links with UN. UN Wire. 5 June 2000.

USAID (2004). Microfinance for Special Groups: Refugees, Demobilized Soldiers, and Other Population. MBP Microfinance Following Conflict, Brief No. 7.

Watchman, Paul Q./Delfino, Angela/Addison, Juliette (2007). EP2: The Revised Equator Principles: Why hard-nosed bankers are embracing soft law principles. Lamb LeBoeuf, Green & MacRae.

Wehnert, Ulrich/Shakya, Roshan (2003). Microfinance and Armed Conflict in Nepal: The Adverse Effects of the Insurgency on the Small Farmer Cooperatives Ltd. (SFCLs). Rural Finance Nepal (RUFIN); Working Paper No 3. Kathmandu, Agricultural Development Bank of Nepal; German Technical Cooperation GTZ.

Weiss Fagen, Patricia/Bump, Micah N. (2006). Remittances in Conflict and Crises: How Remittances Sustain Livelihood in War, Crises, and Transitions to Peace. Policy Paper, February. International Peace Academy; Georgetown University.

Wennmann, Achim (2007). Money Matters. Economic Dimensions of Peace Mediation. PSIS Occasional Paper No 4. Programme for Strategic and International Security Studies. Geneva.

WFP/OCHA (2007). Impact of Conflict and Priorities for Assistance. http://www.un.org.np/reports/WFP+OCHA/2007/2007-10-02-OCHA_WFP-The-Impact-of-Conflict-in-Nepal-WFP-OCHA.pdf. Accessed 13 October 2008.

Winer, Jonathan M. (2002). Illicit Finance and Global Conflict. Economies of Conflict: Private Sector Activity in Armed Conflict. Oslo, FAFO.

Winer, Jonathan M. (2005). "Tracking Conflict Commodities and Financing." Karen Ballentine and Nitzschke, Heiko, Eds. Boulder, Lynne Rienner: 69-93.

World Bank (2002). Nepal. Financial Sector Study. Report Number: 24959-NEP, World Bank.

World Bank (2007). Access to Financial Services in Nepal. Washington.

World Bank/DIFD/ADB (2006). Nepal. Resilience Amidst Conflict. An Assessment of Poverty in Nepal, 1995-96 and 2003-04. Washington, World Bank.

WWF/Banktrack (2005). Shaping the Future of Sustainable Finance. Moving from Paper Promises to Performance.

swisspeace Publications

Working Papers
(CHF 15.- plus postage & packing)

3 | 2008
Ulrike Joras
"Financial Peacebuilding"-
Impacts of the Nepalese conflict
on the financial sector and its
potential for peacebuilding
November 2008
ISBN 978-3-908230-73-1

2 | 2008
Dennis Dijkzeul
Towards a Framework for the Study
of "No War, No Peace" Societies
April 2008
ISBN 978-3-908230-71-7

1 | 2008
Ulrike Joras, Adrian Schuster (eds.)
Private Security Companies and Local
Populations: An Exploratory Study of
Afghanistan and Angola
April 2008
ISBN 978-3-908230-72-4

3 | 2007
Danielle Lalive d'Epinay, Albrecht Schnabel (eds.)
Transforming War Economies
October 2007
ISBN 978-3-908230-70-0

2 | 2007
Marie-Carin von Gumppenberg
Kazakhstan - Challenges to the
Booming Petro-Economy.
FAST Country Risk Profile Kazakhstan
September 2007
ISBN 978-3-908230-69-4

1 | 2007
Nika Stražišar
Peacebuilding and Organized Crime.
The Cases of Kosovo and Liberia
August 2007
ISBN 978-3-908230-67-0

3 | 2006
René Lemarchand
Burundi's Endangered Transition.
FAST Country Risk Profile Burundi
October 2006
ISBN 3-908230-65-9

2 | 2006
T.K. Vogel
Bosnia-Herzegovina: The Challenge of Legitimacy.
FAST Country Risk Profile Bosnia and
Herzegovina
October 2006
ISBN 3-908230-66-7

1 | 2006
Kathrin Wyss
A Thousand Hills for 9 Million People
Land Reform in Rwanda: Restoration of Feudal
Order or Genuine Transformation?
FAST Country Risk Profile Rwanda
März 2006
ISBN 3-908230-63-2

5 | 2005
Alexandra Geiser
Social Exclusion and Conflict Transformation in
Nepal: Women, Dalit and Ethnic Groups.
FAST Country Risk Profile Nepal
September 2005
ISBN 3-908230-62-4

4 | 2005
Christopher Tütsch
Kosovo's Burdensome Path to Economic
Development and Interethnic Coexistence.
FAST Country Risk Profile Kosovo
August 2005
ISBN 3-908230-61-6

3 | 2005
Solofo Randrianja
Ravalomanana, 2002-2005.
Des produits laitiers aux affaires nationales.
FAST Country Risk Profile Madagascar
Août 2005
ISBN 3-908230-59-4

2 | 2005
Reto Weyermann
A Silk Road to Democracy?
FAST Country Risk Profile Kyrgystan
February 2005
ISBN 3-908230-57-8

Conference Papers
(CHF 15.- plus postage & packing)

1 | 2008
Didier Péclard (ed.)
swisspeace Annual Conference 2007
Environmental Peacebuilding: Managing Natural Resource Conflicts in a Changing World
December 2008
ISBN 978-3-908230-74-8

1 | 2007
Jonathan Sisson (ed.)
swisspeace Annual Conference 2006
Dealing with the Past in Post-Conflict Societies: Ten Years after the Peace Accords in Guatemala and Bosnia-Herzegovina
September 2007
ISBN 978-3-908230-68-7

1 | 2006
Rita Grünenfelder and Heinz Krummenacher (eds.)
swisspeace Annual Conference 2005
Searching for Peace in Chechnya - Swiss Initiatives and Experience
March 2006
ISBN 3-908230-64-0

1 | 2005
Laurent Goetschel und Albrecht Schnabel (Hrsg.)
swisspeace Jahreskonferenz 2004
Stärkung der Zivilgesellschaft als Mittel der Friedensförderung?
Erfahrung des Afghan Civil Society Forum (ACSF)
September 2005
ISBN 3-908230-60-8

1 | 2003
swisspeace Annual Conference 2003
Adding Fuel to the Fire - The Role of Petroleum in Violent Conflicts
April 2004
ISBN 3-908230-52-7

1 | 2002
swisspeace Jahreskonferenz 2002
Die Friedenspolitik der Schweiz. Akteure - Instrumente - Perspektiven
November 2002
ISBN 3-908230-50-0

Information Brochures

swisspeace Annual Report in German, French and English

NCCR Brochure in German, French, English and Russian

Peace Mediation Essentials

Cordula Reimann
Gender and Peace Mediation
swisspeace / MSP, August 2008

KOFF Newsletter

For a subscription to the KOFF e-mail Newsletter please access **www.swisspeace.org/koff**

Other Publications

A complete list of publications can be found at www.swisspeace.org/publications.

Order Form

Working Paper N° ______________________________

Conference Paper N° ______________________________

Other Papers ______________________________

Title / Author ______________________________

____

____

____

Name ______________________________

First Name ______________________________

Institution ______________________________

Street ______________________________

Zip-Code, City ______________________________

Country ______________________________

Tel/Fax ______________________________

E-mail ______________________________

Date ______________________________

Signature ______________________________

Please send or fax to:

swisspeace
Sonnenbergstrasse 17
Postfach, 3000 Bern 7, Schweiz
Tel: +41 (0)31 330 12 12
Fax: +41 (0)31 330 12 13
info@swisspeace.ch
www.swisspeace.org

Schweizerische Friedensstiftung
Fondation suisse pour la paix
Fondazione svizzera per la pace
Swiss Peace Foundation

swisspeace

Sonnenbergstrasse 17
P.O. Box, CH-3000 Berne 7
Tel +41 (0)31 330 12 12
Fax +41 (0)31 330 12 13
info@swisspeace.ch
www.swisspeace.org