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Stabilizing Influence: *Micro-Financial Services Capability*

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AN ORGANIC MICRO-FINANCIAL SERVICES (MFS) capability in U.S. military units should be formally established as a key mission enhancer or "force multiplier" to support stability and reconstruction operations (SRO). Both FM 3-24, *Counterinsurgency,* and the Marine Corps manual *Countering Irregular Threats: A Comprehensive Approach* specifically note the need for MFS. However, neither manual goes into any detail on what MFS actually involves or how commanders in SRO environments should use them. This article aims to fill that gap.

Prior to the recent update of U.S. Army counterinsurgency doctrine, veterans of SROs and humanitarian interventions recognized that stability ultimately hinges on the restoration and promotion of economic viability. The recent update of Army and Marine Corps counterinsurgency doctrine has since acknowledged economic development as a key component of stability operations.

At the heart of current counterinsurgency doctrine is the notion that the people are the key "terrain" in SRO. Thus, Soldiers must influence the indigenous people favorably to win their approbation. To do this, they have to understand how to affect "the social, ethnographic, cultural, economic, and political elements of the people among whom a force is operating" and apply specific tailored measures derived from that understanding.[1] Consequently, in operating environments where non-coercive skills are at least as important as coercive ones, Soldiers must bring more than mere force into play.

Close analysis of how to succeed within an insurgency framework suggests that providing immediate economic opportunities to the population is second only to providing physical security; thus, among the tools needed to cope with insurgencies is a bottom-up economic strategy linked to security measures. Such a strategy has to create the conditions for economic opportunity while also encouraging the population to participate in generating overall economic recovery.[2]

Unfortunately, all too often these efforts to encourage economic opportunity and participation focus on large-scale economic activities such as building power or manufacturing plants. Such projects require detailed planning, take time, and often are hampered by politics and bureaucracy. Meanwhile, as the projects move ponderously along, insurgents exploit the perceived lack of economic opportunity and progress. They feed off the unmet and perhaps unrealistic expectations of the populace.

Given the above, it seems that a more effective means of dealing with the close-in economic fight is with time-sensitive, small loans to micro-businesses.

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PHOTO: An interpreter helps an Iraqi businessman understand the application process for micro-grants at the governance center in Arab Jabour, Iraq, 24 January 2008. (U.S. Army, SGT Kevin Stabinsky)

Delivery of micro-financial services to small-scale entrepreneurs during SRO can quickly stimulate economic activity, serving to undercut insurgent exploitation of economic instability. Quick, tangible results at low levels of commerce can create local buy-in and commitment from the populace. Such community investment can then serve to help garner support for government efforts to reestablish sovereignty and governance. Often underutilized or misunderstood by military forces, MFS is actually a simple but sophisticated tool that, when used properly, can deliver economic benefits to a target population at a comparatively cheap cost. Compared to grander projects that may take months and years to develop, small businesses realize economic benefit fast enough to improve stability.

Financial Problems

Challenges facing countries during SRO campaigns are similar to the problems non-governmental organizations (NGO) have handled for decades when working with large, poor populations in stressed environments. Consequently, NGO experiences provide many lessons. Among the more important that the intervening organization must understand is the limitations indigenous financial institutions may have in straitened conditions. For example, many unstable countries have long established banking institutions, such as those that currently exist in Iraq and Afghanistan. However, experience has shown that many such institutions have neither the infrastructure nor capital to meet extensive borrower needs broadly across society. They cannot handle the administrative costs of dealing with the vast numbers of small-scale borrowers upon whom economic stability actually depends. Interest returns on small-scale loans don't cover the time and resources required to process them

This is especially true in conflict or post-conflict zones, when a bank's survival can depend on high-yield clients. Granting loans to large numbers of small-scale entrepreneurs becomes economically unfeasible when continuing violence is a constant threat looming over both the entrepreneur's business and the bank's investment. Thus, a nagging shortage of capital, combined with great insurgency-related risk, often results in banks choosing to deal with only well-connected clients in safe areas where returns on investment are likely. This unfortunate set of circumstances stunts overall economic development and usually precludes investment in areas and among populations that may be most in need of the stabilizing influence economic opportunity and development provides.

Consequently, small-scale borrowers—usually from the poorer classes—often have no other recourse but to turn to pawnshops and neighborhood moneylenders to acquire needed finances. Such lenders often lend money only as long as borrowers have a commodity to leverage. Moreover, they usually charge crippling interest fees for their services, especially in times of shortage and risk like those prevailing during insurgency conflicts. The above combination of factors compounds the economic damage that an insurgency causes by quickly depleting the cash reserves of the most underprivileged segment of a population. Disaffection, stemming from a loss of economic security compounded by insecurity and a declining quality of life, often increases sympathy for insurgent activities.

At the same time, such conditions undermine support for or confidence in the government. Straitened conditions nullify any attempts at broader SRO civic and security efforts as local populations frequently come to see SRO forces, rather than insurgents, as the source of social instability and personal misfortune and misery. The problem is complicated when insurgent groups position themselves as alternate sources of services, becoming in effect shadow governments. Such services often include economic relief for a population living in desperate circumstances. Insurgents' perceived economic successes increase popular estrangement from the government by undermining its legitimacy. This estrangement also helps to create an insurgent recruiting pool that may potentially encompass an entire local population.

For the above reasons, establishing economic opportunity must be a key component to any SRO

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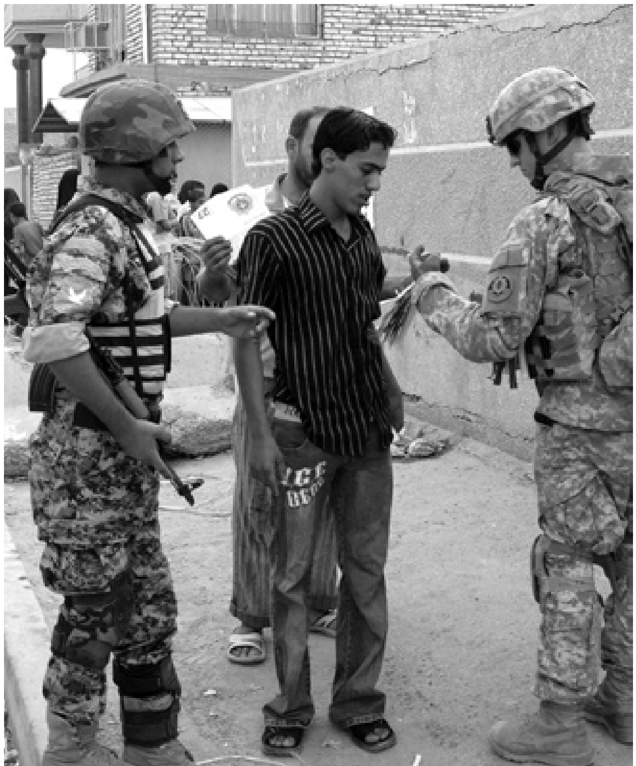
strategy. As entrepreneurs establish small businesses and create jobs, economic opportunity spreads and leads to viable, self-sustaining stability. Micro-financial services is one tool commanders at all levels can use to promote the essential economic development and opportunity at the local level.



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Iraqi National Police provide security and other assistance to U.S. Army Soldiers holding a financial-grant signing for business members in Baghdad, Iraq, 20 October 2007.

History of MFS

The concept of MFS is not new. It can trace its roots to activities by medieval guilds and village social clubs, which provided low- or no-interest loans to their members in ways we would view today as micro-credit. Societies whose membership was reserved for those practicing similar occupations, or groups having an interest in promoting a specific trade for the common good of local communities, would pool their resources to help individual members establish themselves as viable businesspersons. Larger, more formal institutions developed in Ireland in the 1700s and Germany in the 1800s as altruistic organizations to help their poor escape abject poverty and the crushing debt of moneylenders. Similarly, in the 1900s, government-led institutions began providing targeted loans to protect small agricultural interests.[3]

The modern incarnation of such micro-credit practices began in the 1970s via pioneering work by ACCION International, Self-Employed Women's Association Bank, and Grameen Bank, the last of which became the model for modern micro-financial institutions. Grameen Bank's founder, Dr. Muhammad Yunus, won the Nobel Prize in 2006 for his work there. Yunus, a classically trained economist who taught in Bangladesh in the 1970s, confronted poverty as he commuted to and from work and decided to investigate why economic practices were not dealing with it. He and his students interviewed 42 local women and discovered that the women relied on frequent loans from moneylenders to meet their supply needs to run their businesses. After paying off the interest on their loans, they had little profit left to reinvest into their businesses. Yunus found that with as little as $27 each, business owners could bypass the moneylenders and deal directly with their suppliers. He supplied $27 to each of the 42 women, and they repaid him in several weeks with each owner having enough left over to do business without the moneylenders. Yunus sought government support to establish the first Grameen Bank, which still operates today. It serves 5 million customers with a loan recovery rate of 98.9 percent.[4] Grameen was unique because it created a sense of collective responsibility among its borrowers. Each member's loan repayment increased available credit for the remaining borrowers, which created a powerful incentive for all of them to make prompt loan payments.

After the success of the micro-financial institutions of the 1970s, many NGOs have developed similar MFS capabilities and practices. Over the past three decades, the success of these efforts has demonstrated MFS effectiveness in dealing with the economic needs of disadvantaged populations. However, an understanding of the various dynamics associated with poverty, the obstacles to economic development, and how micro-credit could be best applied has taken years to develop and adjust.

In the 1980s, it became evident that micro-credit was inadequate to deal with all of the poor's problems because it did not address the complex situations they faced. Aid agencies recognized that the poor needed a full-service financial approach. With proliferation of micro-credit services in the mid-1990s, a shift occurred from solely focusing on micro-credit to providing MFS more broadly. This led modern micro-financial institutions to become full-service banks.[5] Institutions providing loans and savings services advanced to other basic financial services. In concept and practice, they now offer the same services provided by banks in developed nations. The difference lies in the amount of funds in play. Micro-financial institutions address financial needs in a given locality, and loans that some might regard as miniscule are common.

Micro-Financial Expertise

Military planners should study the lessons of NGOs and adopt their methods for coping with similar economic situations in financially unstable countries. U.S. military units have two organizations that deal directly with the economic conditions in unstable areas where micro-financial institutions might be effective: the civil-military operations center (CMOC) and the specialized civil affairs team (CAT).

Civil-military operations centers are ad hoc organizations that coordinate and unify the capabilities of military and civilian agencies in an area to address SRO's human dimension. Specialized CATs work out of the CMOC and provide physical security, humanitarian help, civil administration, public institution development assistance, and economic rehabilitation and development to meet the needs of the local population.

Each CMOC has an economics officer, but CATs often outsource the delivery of financial services. Partly because of reliance on outsourcing, the military has not leveraged the benefits of providing financial services to their maximum potential.

The outsourcing habit grew from a decision the U.S. military made in the 1990s when it faced increasing SRO missions and the constraints of a shrinking budget. Consequently, the military developed doctrine calling for extensive use of outside support and expertise in a joint task force structure. Such support came from agencies both

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A Soldier from the civil-military operations center meets with a local business owner to discuss a micro-grant program and distribute applications in Diwaniyah, Iraq, 4 November 2007.

inside and outside of government.[6] However, the doctrine neither addressed the method and extent of military-civilian integration nor defined specific local economic-development approaches (such as MFS).[7] This nebulous doctrine remains in effect today. Government agencies outside the military have extensive experience with MFS; the military just needs to figure out how to leverage it.

The U.S. government's primary knowledge base for MFS expertise is in the U.S. Agency for International Development (USAID), which has 30 years of experience serving micro-enterprises around the world.[8] It normally funds local micro-financial institutes run by NGOs or charity. But there are problems with this approach. According to retired colonel Joseph J. Collins, former deputy assistant secretary of defense for stability operations—

> While there have been significant exceptions, State and USAID personnel have generally been restricted to relatively secure compounds in Afghanistan and Iraq. This fact is often attributed to the 'tyranny' of the local regional security officers (RSOs), who appear determined to apply peacetime rules to conflict situations. RSOs will likely blame the rules that come down from Washington. In any case, too few Foreign Service officers and USAID professionals [work] in field locations. The personnel strength of State and USAID is clearly inadequate to meet their expanded roles in the War on Terror.[9]

Consequently, MFS does not currently reach effectively out to areas where it might actually have the greatest impact on stabilization.

For example, USAID channels its MFS activities in Iraq through the Izdihar (Prosperity) Organization, which is responsible for a wide variety of financial-development activities. Izdihar issues grants to local micro-financial institutions and conducts training seminars.[10] However, because of the RSO limitations on USAID, only a handful of such institutions have been established in Iraq. These have the capability of disbursing loans of \$3,000 to \$5,000.[11]

While Izdihar's work benefits the Iraqi people, several problems plague the current situation:

- Distance between the local micro-financial institution distributing Izdihar funds and the local Soldier on patrol helps cause a huge synchronization gap that no CMOC can surmount. The distance makes it difficult for Soldiers to target and coordinate needed funds effectively.
- No mechanism exists to guarantee that funds are distributed in a way that will help improve the local economy and to ensure that they are not misappropriated.
- The \$3,000 to \$5,000 range limit denies services to the entrepreneurs most in need of help and the most susceptible to insurgent influence.
- The goodwill created by MFS is not associated with the stabilization forces (which is related to the synchronization gap).

Building an MFS Team

A better approach would be to build and enable a military MFS team that could operate in outlying areas and extend the reach of USAID efforts. As charity groups and NGOs have shown, with MFS the poor can build an asset base and decrease their vulnerability to economic stress. A military tailor-made team would allow commanders to build a plan that fits the specific situation and environment and use MFS to mitigate certain situations. Such a plan would complement a CMOC vision by requiring a statement of how the team expected to deliver their services in coordination with the CMOC.

Thus empowered, the military commander could identify the work force and resources necessary to make the plan work and bring them to bear on the situation immediately if needed. Determining what specific services the local community needs, and in what priority, would be the most important factor in developing such a plan. This identification would come to depend upon military planners who clearly understood who needs MFS and how they would use economic support. For example, needs vary greatly among farmers, shopkeepers, and mechanics; as a result, MFS plans would vary accordingly. In addition, since start-ups as opposed to mature businesses looking for capital have different needs and goals, a nuanced understanding of the area would be necessary.

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Three Key MFS Services

The three most important services an MFS could provide are micro-credit, micro-savings, and micro-insurance. Each service can help a local population obtain a measure of financial stability in the face of a physically threatening environment.

● **Micro-credit.** Micro-sized loans are the premier offering of a standard micro-financial institution. Loan sizes can vary from $5 to $25,000. Though the lower amount may sound miniscule, such seemingly small amounts of money can be life-altering fortunes in underdeveloped countries. The simple fact is that many businesses in countries like Iraq do not actually need the large amounts of capital that Americans might expect.

● **Micro-savings institutions.** Many poor people in unstable and developing countries have no way to store their currency safely. They often hide their savings in their dwellings, sometimes converting their cash to something regarded as a stable commodity, such as jewelry. Such situations are not conducive to economic growth and are often dangerous. Unfortunately, in such cases, the poor are more likely to become victims of looting by criminal and terrorist gangs. Moreover, the victims of theft will often turn their anger against the security force they expected to protect them.

By offering a secure place for citizens to store money safely, and even potentially earn interest on it, a micro-financial institution team can give residents a chance to safely accumulate wealth. Such conditions create goodwill for the stabilization force.

● **Micro-insurance.** In an unstable environment, insurance has utility. Terrorist attacks and criminal violence common to insurgencies, such as bombings in community markets, increase the difficulty of normalizing everyday life. Uncertainty drains the willpower of a local population. Insurance at any level works not only as a hedge against risk, but also helps the policyholder feel protected from the effects of possible unfortunate incidents. With property insurance, a policyholder can at least create a plan, knowing that if a valuable possession (e.g., house, car, donkey) is destroyed, he will be able to replace it. Life insurance can also help the policyholder take greater risks by giving him the peace of mind that family members will be taken care of. Offering any kind of insurance, however, would be risky and should involve trained professionals with enough capital to cover the expenses of a worst-case scenario.

Shaping MFS Teams

Often commanders in destabilized areas will not have the resources to build a large MFS team, but a well-targeted effort can go a long way to help in the reconstruction effort. Whatever service a team offers, the scope of the plan and customer base will dictate the resource and labor requirements the team needs. Military units ranging from battalion to division size can create and use MFS teams. A team can consist of a single reservist (perhaps a bank teller in civilian life) armed only with $250, a lockbox, a calculator, a pen, and some paper. On the other hand, a team can be a group of Soldiers with banking and financial service training operating a bricks-and-mortar bank with a vault, an information technology system, and millions in currency. It depends on the situation.

For example, an applicable model for Iraq might be the "mobile banker" prototype developed in West Africa. To meet marketplace vendor needs in West African towns, bankers travel to the vendors' sites, often daily, to collect deposits or deliver loans. This practice provides the vendor convenient access to financial services and allows the MFS team to monitor the vendor's business and develop personal contacts with the community.[12]

Similarly, Soldiers on patrol might be tasked to engage with local vendors or needy inhabitants on the street and identify them for the mobile MFS team. The goodwill generated by the initiative of military forces in helping to provide financial hope can feed the recipient's pride as well as his stomach and those of his family members.

The Way Ahead

Micro-financial services are not a panacea for dealing with the poor's economic needs. These services require at least a rudimentary level of economic activity.[13] In situations where the local economy has been completely destroyed, food relief, grants, employment and training programs, and infrastructure improvements will be necessary before MFS can be effective. An MFS team works best in an environment where economic activity is already taking place and is capable of expanding. Electricity projects can make power available to a micro-loan customer's storefront. Healthcare

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services can help prevent depletion of one's cash reserves during illnesses.[14] Soldiers who hire locals to work on forward operating bases or public works projects can indirectly increase micro-loan recipients' businesses, and MFS can produce synergies in economic development activities.

Nevertheless, the increasing potential for U.S. forces to be involved in insurgencies should provide impetus to make an MFS capability organic to CATs and available to area commanders. This organic structural capability should be possible. Funds for economic reconstruction already exist for MFS use. A reach-back capability for advice from USAID specialists is also available, and a body of free online literature already provides education on how to make MFS work. Together, these resources provide military forces a great deal of guidance on what they might need to integrate MFS successfully into their stabilization and reconstruction plan.

For the foreseeable future, U.S. forces will be conducting SRO in unstable nations. Military units should have an organic MFS capability so that they have the most effective tools available to develop financial stability in these countries. ***MR***

NOTES

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