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Private Finance, Social Responsibility, and Transitional Justice: The Case for South African Reconciliation and Development Bonds

by Daniel D. Bradlow*

THE RECONCILIATION AND DEVELOPMENT BOND PROJECT (Project) was originally conceived as an attempt to involve the South African expatriate community in the process of national reconciliation that began with the end of apartheid. It has since evolved into a broader effort to promote development and reconciliation by using a creative financing mechanism to raise funding, from both inside and outside the country, for small revenue generating projects that provide jobs, services, and opportunities for poor and historically disadvantaged South Africans.

The paper is divided into three sections. The first section describes the genesis of the Project. The second discusses the design of the Retail Reconciliation and Development Bonds (R&D Bonds). The final section highlights some issues relating to development and transitional justice that arise from the project.

GENESIS OF THE PROJECT

The South African Truth and Reconciliation Commission (TRC) is an historic commission that documented the tragic history of apartheid and promoted accountability for its perpetrators. Unfortunately, the TRC's attempt at redressing the injuries caused by apartheid was less comprehensive: it was limited to an acknowledgment of the wrongs that apartheid had produced and to compensating those people specifically identified in its report as victims of state violence.¹ Thus, the reconciliation work of the TRC was ultimately focused on repairing the relationship between the South African state and black South African citizens.

The TRC did not directly seek to promote reconciliation between ordinary black and white South African citizens. It did not establish any mechanism through which individual white South Africans could acknowledge that they had been beneficiaries of the apartheid system and, therefore, make a gesture of reconciliation. It also did not address the issue of how the South African Diaspora could contribute to reconciliation and development in country.

In principle, there are many forms that this gesture could take. Nevertheless, the history of one of the most successful examples — the reconciliation between Germany and Jews following the end of World War II — demonstrates that one key component of effective reconciliation is money. This is because money helps those who suffered under the old order establish a life that offers them, and their children, better opportunities and more dignity than they had previously.² Money also enables

victims to pay the psychic price involved in moving beyond their pain and anger and reconciling with those who previously oppressed or harmed them.

The Project began as an attempt to address this unresolved issue of reconciliation between different groups of citizens. It was premised on the idea that reconciliation requires those who benefited from apartheid to make a meaningful gesture towards those who suffered under that system. Originally, the goal was to design an appropriate vehicle through which private citizens could make a meaningful contribution to the process of South African reconciliation. Given the poverty of many black South Africans and their limited access to jobs, services, and opportunities, the Project planned to achieve this goal by structuring a

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mechanism through which interested white South Africans, both resident in the country and expatriates, could finance projects that would help poor black South Africans overcome these challenges.

In order for a mechanism to contribute effectively to South African reconciliation and development, it must satisfy three reconciliation-financing criteria. First, it must raise enough money to make a meaningful difference to the situation of poor black South Africans. Second, there must be a sufficiently large number of contributors to the mechanism to demonstrate a serious community-wide interest in reconciliation. Third, it must use the money effectively enough to give all its stakeholders confidence that the mechanism can make a noticeable impact on solving the problems caused by apartheid.

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The most obvious vehicle for raising money for this purpose is a charitable entity to which individuals that wish to make gestures of reconciliation can donate to projects that create jobs, services, and opportunities for those who, historically, were denied access to them. In fact, such an entity was created. It failed because only a relatively small number of people contributed to it.³ This is not to say that there are not enough white South Africans of goodwill who are willing to work for the reconciliation and development of the country. To the contrary, most South Africans, including most white South Africans, do make charitable contributions.⁴ This suggests that there are other reasons that charitable entities fail to attract donations to promote reconciliation. One important contributing factor is that many South Africans are skeptical about the ability of the existing charitable organizations to effectively address the problems of poverty. In other words, charitable giving to promote reconciliation is unable to satisfy the third reconciliation-financing criterion.

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If charities cannot succeed in funding reconciliation, the alternative is to appeal to people’s self interest and offer them an opportunity to invest in reconciliation and development. This method of financing allows interested parties the opportunity to earn a real financial and social return on their investment while funding small scale revenue generating development projects, such as small and micro-enterprises or low income housing. These projects normally have difficulty getting financial support because they are both “too rich” and “too poor.” They are “too rich” for grant funding because they generate revenues that can be used to service a certain level of debt and they are “too poor” for commercial funding either because of the size of the project or because its rate of return is too low to be attractive to a commercial lender.

These investments satisfy the three reconciliation-financing criteria identified above. Because they will yield a real market-based financial return, they have the potential to attract sufficient numbers of interested investors to both demonstrate an interest in promoting reconciliation and to fund enough development projects to have a meaningful impact on poverty, inequality, and unemployment in South Africa. Furthermore, if the investments meet certain financial and social standards, they can demonstrate that they are, in fact, contributing to the building of a better future for all South Africans.

There are two ways in which such investment vehicles may operate — either through equity investments or debt financing. The first is to establish an investment fund that makes equity investments in qualifying projects. The attraction of equity for development financing is that investors do not earn a return on their investment until the projects generate profit. Equity investments, however, are problematic vehicles for promoting reconciliation. They can be perceived as a way for white South Africans to both profit from the hard work of those black South Africans who suffered under apartheid and to control (through the voting rights associated with equity) the efforts of those they previously oppressed.

The second option is to use debt to finance the investments. This has a number of attractive advantages related to development and reconciliation. First, debt establishes a fixed term contractual relationship between the investor and the recipient of the funds. Once debtors have fully performed the agreed upon contractual obligations, they are both independent of the creditor and in a materially better condition than before the debt transaction. Second, the debtor, through reliable servicing of the debt, can establish a credit history which should enhance its access to future financing. Third, if the debt arrangement is structured so that the borrower receives the funding on better terms than are available from any other available funding source, the transaction can facilitate better relations between debtor and creditor, thereby promoting reconciliation. The extent to which debt financing promotes development and reconciliation depends largely on this last point because if the borrower perceives the terms of the debt to be too harsh, the debt transaction can undermine, rather than promote, reconciliation.

In order for debt financing to satisfy the three reconciliation-financing criteria, the funds should be raised through an instrument that both appeals to as broad a group of individuals as possible and raises a substantial amount of money for qualifying development projects. The only instrument that meets these requirements is a retail bond issued on the South African domestic market. In addition to appealing to South African residents, the instrument will also appeal to expatriates who have an interest in promoting reconciliation and development in the country.

Given the realities of distributing and servicing retail bonds, any attempt to use them for reconciliation and development purposes must satisfy a fourth reconciliation-financing criterion — it must be attractive to financial institutions. Their participation will help convince potential investors that this is a legitimate financial transaction in which they can earn both a reasonable financial return and produce noticeable social benefits for South Africa and its poor. Financial institutions can also provide the distribution network through which the bonds are sold.

The Project has therefore become an effort to create and issue a bond that is capable of meeting all four reconciliation-financing criteria. Its proposed structure, which was developed after extensive consultation with all stakeholders and a range of technical experts, is described in the next section.

THE STRUCTURE OF THE PROJECT

The Project is currently designed to raise R1 billion⁵ to fund a range of development projects through two instruments — a Subordinated Instrument (SI) and a retail R&D Bond. The two instruments will each seek to raise R500 million for a term of ten years. Both the SI and the R&D Bond will be issued by the

Project Issuer (PI), a private non-profit, tax exempt company created for this purpose. The PI's Board of Directors, which will include representatives of the financial institutions that invest in the Project, will represent all Project stakeholders, and will have a small staff whose job will be to manage its relations with the other actors in the project.

THE SUBORDINATED INSTRUMENT (SI)

The SI will be sold to financial institutions, corporations, and foundations. The funds it raises will be managed by experienced fund managers who are contractually obliged to invest the proceeds in commercial projects that satisfy a set of agreed prudential, financial, social, and environmental criteria. The resulting income will be used to pay all operating costs for the PI and to help pay the interest on the R&D Bonds in the early years of the Project.

The SI will offer investors the following benefits:

1. Upon maturity, purchasers will receive a lump sum payment equal to their original investment, plus a stipulated pro rata share of the surplus remaining after all other Project related obligations have been satisfied.
2. The Project's investments will entitle qualifying SI holders to score points towards their sectoral charter obligations.⁶
3. A tax benefit that is available to investors under the current law.⁷
4. Banks that are holders of the SI will benefit from the banking business generated by the Bond Project.
5. The project structure will enable interested SI holders to learn about the risks and rewards of doing business with the small scale project funded by the retail R&D Bonds.
6. The holders will profit from the goodwill created by their participation in the Project.
7. All SI investors will receive an annual report describing the projects being funded by the Project and detailing the social benefits that have accrued from these projects.

THE RETAIL R&D BONDS

The R&D Bonds will be a non-tradable debenture with a periodic interest payment. Bonds will be sold for R500 per bond and each bond will carry an interest rate equal to the rate offered by the Government of South Africa on its five-year Government Retail Bond, which at the time of writing (October 2007) is 10.0 percent.⁸ The principal will be repaid at the end of the ten-year term of the R&D Bond. It is expected that the bond will be bought by those South Africans with some disposable income, expatriate South Africans, and friends of South Africa. All bondholders will receive the same annual report as the one given to SI investors.

All proceeds raised through the R&D Bond will be invested in activities that meet the goals of the Project. The PI will be responsible for arranging for the investment of these funds. The PI itself will not directly invest the funds raised by the R&D Bond, instead it will enter into contractual arrangements with four to six "Implementing Agencies" (IAs) that are in the business of investing in the types of activities that the Project is designed to support. These IAs will be responsible for identifying the projects to which the funds will be loaned, and for working with their sponsors to make sure they succeed and are able

to repay their debts to the IAs. The use of 4-6 IAs will allow for some variety in the skills, experience and scope of operations of the IAs, and for some diversification of risk.⁹

The contract between the IAs and the PI will include three sets of provisions to ensure that the Bond proceeds are only used to fund qualifying projects. First, the funds can only be used to finance projects that meet a set of agreed criteria. These criteria will both establish a principled basis for holding the IAs accountable for their use of the money and a predictable basis on which the PI can reject non-conforming project proposals. Second, the contract will oblige the IA to invest a stipulated amount of money over a number of years; however, the IA cannot access the funds until it provides the PI with a project proposal that complies with the terms of the contract. Once the PI approves the project, the fund manager will transfer the necessary funds to a dedicated bank account controlled by the IAs and the PI. The funds will only be disbursed from this account for approved project related expenditures. Third, the contract will make clear that the IA is responsible for repaying, together with the stipulated interest rate, the funds advanced by the PI.

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ISSUES ARISING FROM THE PROJECT

The Project raises a number of interesting issues that merit further investigation. First, the Project highlights the fact that most transitional justice efforts involving prosecutions and truth commissions focus on the relationship between the state and those who suffered under the old order. They only indirectly address the relations between the different social groupings that were involved in the conflict. It is not possible for a post-conflict society to achieve sustainable peace if these social groupings do not directly reconcile with each other. Consequently, there is a need to supplement the state's transitional justice efforts with mechanisms that promote reconciliation between these non-state social groupings. The Project demonstrates that it is possible to use innovative applications of traditional financial instruments to promote reconciliation between the different groups within a post-conflict society. This is particularly important given that financial compensation has proven to be one of the most effective ways to promote reconciliation.

Second, the Project demonstrates that it is possible to involve the expatriate elements of the different social groupings in these reconciliation efforts. Consequently, the bonds can become a useful way for a country to simultaneously raise funds from its local middle and upper classes and its diaspora.¹⁰

Third, the Project raises an interesting question about the nature of the investment approaches used by most financial institutions. The initiatives that the Project aims to support have difficulty raising funds because they do not meet either of the two usual sets of criteria that financial institutions use in making their lending decisions — those used in commercial lending and those used in allocating their corporate social responsibility funds. As explained above, the projects to be funded by the R&D Bonds do not meet the criteria financial institutions use in extending credit on commercial terms. In addition, because they generate a stream of income, these projects are not viewed as attractive candidates for support from the donations that financial institutions make as part of their social responsibility. This suggests that financial institutions, particularly those in poor countries, need to rethink their approach to business and social responsibility. Instead of dividing all their investment activities into either one of these two categories, businesses should consider them as the two end-points of a spectrum of activities that range from profit maximizing activities at the one end to goodwill generating gifts at the other. The Project offers these institutions an opportunity to experiment and to learn more about how to identify other points along this spectrum.

Fourth, the Project offers foundations and other grant makers the opportunity to learn about how they can support sub-commercial revenue generating projects that produce jobs, services and opportunities for poor people. It should provide them with

useful data on how they can adapt their grant making expertise to investing in these categories of development work.

Fifth, the Project offers an opportunity to experiment with measuring the social returns generated by small-scale revenue-generating development projects. Currently, there are not well established methodologies for measuring such returns. The Project proposes to provide each investor in the project with a detailed annual report on the investments being made by the IAs. These reports will inform investors about the social benefits that their investments are producing and hold the IAs and PI accountable for their use of the Bond proceeds. The empirical data that this generates can be used by interested parties to test methodologies for measuring social returns on investments. Such methodologies can help similar projects demonstrate that they are meeting the third reconciliation-financing criterion, namely that they are having a meaningful impact on poverty alleviation and development.

CONCLUSION

THE PROJECT WAS ORIGINALLY CONCEIVED as a vehicle for promoting reconciliation, but it has evolved into an innovative reconciliation and development financing project. The Project, if successfully implemented, has the potential to be scaled up and to be replicated in a number of different countries and regions.

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ENDNOTES: PRIVATE FINANCE, SOCIAL RESPONSIBILITY AND TRANSITIONAL JUSTICE

1 Truth and Reconciliation Commission of South Africa, *Truth and Reconciliation Commission of South Africa Report* section 2, ch. 11 (March 21, 2003), available at <http://www.info.gov.za/otherdocs/2003/trc/> (last visited Nov. 5, 2007).

2 The lesson from the case of German reparations has been confirmed in a study of reparations in the Czech Republic. See Roman David & Susanne Choi Yuk-ping, *Victims on Transnational Justice: Lessons from the Reparation of Human Rights Abuses in the Czech Republic*, 27 HUMAN RIGHTS QUARTERLY 393 (2005).

3 Following the release of the TRC report, a group of South Africans established the “Home to All Campaign,” which established a Development and Reconciliation Trust that accepted donations from the public and made grants to projects to promote literacy and other poverty-fighting efforts in South Africa. The Trust has collected some funds and has awarded some grants but the amounts were relatively small. The author worked with the Campaign and the Trust in developing this Project.

4 David Everatt & Geetesh Solanki, *A Nation of Givers: Social Giving among South Africans*, The State of Social Giving in South Africa Report Series, Research Report No. 1.

5 The exchange rate between the South African Rand and the US Dollar fluctuates between about SAR 6-7.5 to USD 1. Thus R1 billion is equal to about \$143 million.

6 See Financial Sector Charter (2003), available at http://www.banking.org.za/documents/2003/OCTOBER/Charter_Final.pdf (last visited Nov. 5, 2007). Under the Broad Based Economic

Empowerment Act (53) 2003, all sectors of the South African economy are required to develop charters that establish standards, dealing with equity ownership, management, procurement, and investment, for transforming that sector so that it is more open to and representative of the whole South African population. Companies that fail to comply with these standards may be precluded from doing business with the government and may become less attractive to other private companies with whom they do business (because of the implications for the latter group of companies’ own procurement requirements). The most relevant charter for the R&D Bonds project is the Financial Services Charter, which, *inter alia*, requires financial institutions to make significant investments in low income housing, small medium and micro-enterprises, and certain infrastructure projects that are designed to help develop previously underserved communities.

7 Income Tax Act 58 of 1962 s. 11(a).

8 See National Treasury, Retail Savings Bonds, at www.rsaretail.bonds.gov.za (last visited Nov. 5, 2007).

9 The author, with the support of the Wallace Global Fund, has hired a consultant to identify the most suitable IAs.

10 It should be noted that making the bonds available to the diaspora may raise securities law issues in their host countries.