DRAFT FOR DISCUSSION

A GUIDE TO ECONOMIC GROWTH IN POST-CONFLICT COUNTRIES

Economic Growth Office

Bureau for Economic Growth, Agriculture and Trade

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Preface

This is the first effort we are aware of to develop comprehensive recommendations for encouraging economic growth in countries emerging from conflict. It is based on the premise that improved economic well-being can enhance the prospects for sustaining peace and can reduce the high percentage of post-conflict countries that return to violence.

The guide is based on a three-day workshop organized by the Economic Growth Office of USAID's EGAT Bureau in March, 2007, augmented by input from individuals in EGAT, USAID generally, other U.S. Government agencies (including the Department of Defense), the World Bank and International Finance Corporation, and several bilateral donors and think tanks. The views expressed here are those of the individuals concerned and the Office of Economic Growth. They do not necessarily reflect the views of the Agency for International Development or the United States Government.

The guide was originally intended for USAID field officers. As it developed, we realized that what we were learning would be useful to a broader audience. We removed many, but not all, USAID-specific references and sought examples and case studies from the experience of others. We encourage readers to draw lessons for their own organizations and needs.

The guide should be viewed as a work in progress. Economic growth has often been treated as an afterthought in post-conflict recovery and has received relatively little attention from donors working on post-conflict problems. Far from being the last word on this subject, the guide may best be viewed as the first. We are aware of additional steps that would improve the guide, but they would take time. It seemed best to get what we have out for discussion rather than wait to fix all shortcomings. We will be pleased if the guide spurs comment and further thought and pleased too if it leads to improved versions – by us or by others - as experience builds. We plan to create an online forum shortly to capture comments, new thinking and new experience in this area. Until that is set up, comments should be directed to DDod@usaid.gov and will be warmly received.

I wish to express my appreciation for the staff of EGAT who assisted to draft this paper and for the professionalism they demonstrated showing how conventional development approaches can be adapted to the different world of post-conflict societies. Particular thanks is due to James (Jay) T. Smith, Robert Aten, and David Dod, who made sense out of the large and growing literature, who drew thoughtfully from their own experience and that of others, and who articulated the outcome so clearly here.

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EXECUTIVE SUMMARY

This Guide to Economic Growth in Post-Conflict Countries seeks to fill a gap in the information available to decision-makers faced with the urgent, all-encompassing needs of a country emerging from conflict. The guide brings together lessons learned from past and current efforts to promote economic growth in post-conflict countries. It proposes a new approach and provides concrete recommendations for establishing effective economic growth programs that will improve well-being and contribute to preventing a return to conflict. The guide does not provide a checklist applicable in all post-conflict settings, although it does provide the basis for constructing a checklist appropriate to a specific country context.

The lessons learned and program recommendations in the guide also are applicable in situations where conflict has been limited to specific geographic regions within a country, such as northern Uganda and southern Sudan. However, because there still is much to be learned about how economic growth programs contribute to ending a conflict, it is unclear whether the concepts presented here also apply in countries currently in the midst of general conflict. Accordingly, the guide's programming suggestions should not be applied unquestioningly in mid-conflict situations.

The guide is intended to be practical; it can be applied in the chaotic circumstances that prevail in post-conflict settings. Part 1, *The New Approach to Post-Conflict Recovery* describes the economic impact of conflict and suggests ways to set economic growth priorities. Part 2, *Best Practices*, discusses lessons learned and provides recommendations for seven specific sectors: 1) macroeconomic foundations, including both fiscal and monetary policy and institutions; 2) employment generation; 3) private-sector development, including both the private-sector enabling environment and enterprise development; 4) agriculture; 5) banking and finance; 6) trade policy and institutions; and 7) infrastructure.

Economic growth programs: a significant part of the solution

The purpose of economic growth programming in post-conflict countries is both to reduce the risk of a return to conflict and to accelerate the improvement of well-being for everyone, particularly the conflict-affected population. Economic issues may have contributed to the outbreak of violence in the first place, through an inequitable distribution of assets and opportunities or simply a widely held perception of inequitable distribution. Economic interventions need to be an integral part of a comprehensive restructuring and stabilization program. While economic growth is not the sole solution to resolving post-conflict issues, it can clearly be a significant part of the solution.

A new approach

Evidence shows that early attention to the fundamentals of economic growth increases the likelihood of successfully preventing a return to conflict and moving forward with renewed growth. Since 40 percent of post-conflict countries have fallen back into conflict within a decade, it is critically important to heed this evidence and alter the familiar donor approach, which focuses first on humanitarian assistance and democracy-building, with economic issues sidelined to be dealt with later.

Start early: Paul Collier, an Oxford University economist and leading expert on African economies, argues that external peacekeepers and robust economic growth have proven to be more critical than political reform in preventing a return to conflict.[1] Accordingly, many interventions geared to facilitate economic growth can and should be implemented at the very beginning of the rebuilding process, much earlier than traditionally has been the case.

Address the causes of conflict: It is critical to understand that paying immediate attention to economic growth does not mean doing the same thing that ordinarily is done in stable developing countries. Post-conflict environments demand a different approach. Countries emerging from violence have fundamentally different characteristics as a result of conflict. Most were already poor, badly governed developing countries prior to the outbreak of violence. Their problems were almost always made worse by conflict. More importantly, the nature of many of their problems also changed. Post-conflict settings are characterized by physical and human destruction; dislocations, unemployment, and demobilization of combatants; a weak and fragile government; high expectations and a sense of urgency; and residual geographic, ethnic, or other tensions.

Post-conflict economic growth programs must address as directly as possible the factors that led to the conflict, taking into account the fragility of the environment. Planning has to be based on much more than narrow technical considerations of economic efficiency and growth stimulation. Programs also must be effective at opening up opportunities and increasing inclusiveness; they should be judged in part on the basis of whether or not they help mitigate political factors that increase the risk of a return to hostilities.

What's required for success?

Clear goals: Clear goals are critical, because—in the chaotic circumstances that characterize the post-conflict period—everything seems to be needed at once, and there may be many actors with differing priorities. Each post-conflict situation is different, but in general, economic growth programs should aim to:

- reestablish essential economic governance functions and restore the government's legitimacy
- boost employment and improve well-being as quickly as possible
- address the root economic causes of the conflict
- stabilize the economy and position it to grow rapidly

Sensitivity to context: In the post-conflict context, there must be heightened sensitivity to the political and social dimensions of the conflict. Economic growth programs must address these dimensions. Donors must consider the nature of the conflict, the nature of the peace, and the country's level of development as it emerges from the conflict. To be effective in such a sensitive political environment, every rebuilding decision should include a consideration of the impact it may have on the legitimacy of the government, on employment and improved welfare, and on equity or perceptions of equity.

A pragmatic approach: At the core of all donor-supported economic growth programs must lay a highly pragmatic approach, based on an understanding of the critical barriers to resuming growth. Such an approach works on simple issues first, removes barriers to the informal sector, and is structured in a way that offers the greatest immediate benefits in an equitable manner.

Host-country ownership: Post-conflict economic growth programs need to be carried out with full host-country ownership of the reforms, using national systems as much as possible. In addition, initiatives

[1] P. Collier, A. Hoeffler and M. Soderbom, *Post-Conflict Risks* (Centre for the Study of African Economies, Department of Economics, University of Oxford, 2007).

should be developed through a well-coordinated process that integrates multiple donors and the host government.

How should it be done?

Donors should begin work in multiple areas immediately and simultaneously, and begin early on to build long-term capacity.

Focus on the basics: Economic growth programming should focus on the basics of a functioning economy, with early emphasis on short-term effectiveness in stimulating economic activity and creating jobs, rather than on longer-term economic efficiency. In general, short-term results should trump longer-term issues in terms of programming choices. There are, however, no hard-and-fast rules about these trade-offs. Judgment must be applied in every case.

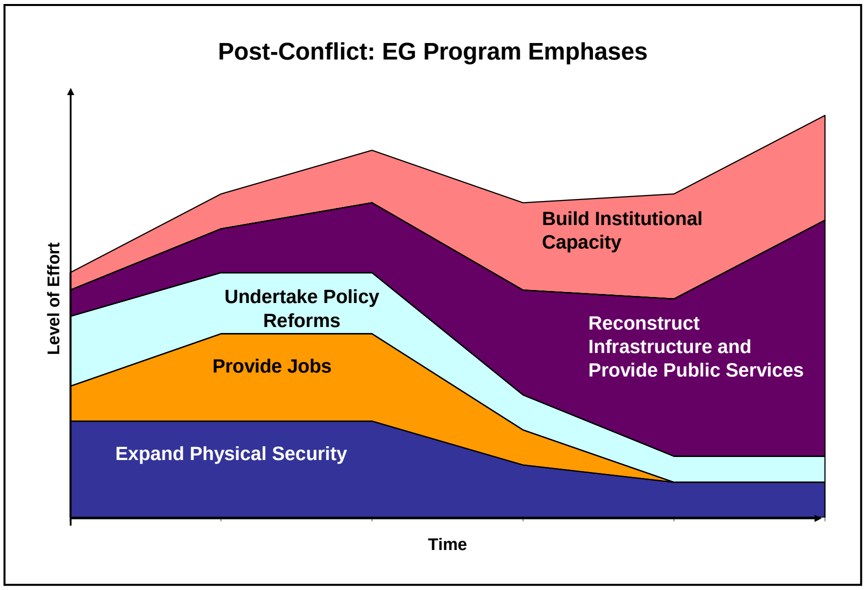
Establish priorities: During the immediate post-conflict period, there may be a narrow window of opportunity to introduce difficult economic reforms. There also may be extreme limits on the government's capacity to implement change. Often, so many changes are needed that donors have to set immediate priorities on the basis of what will most quickly and most effectively generate employment and stimulate the economy.

Understand recurring trade-offs: Substantial structural challenges and the ever-present risk of a return to conflict mean that donors need to make decisions quickly, and on the basis of specific trade-offs that are much more acute than in stable developing countries. Four trade-offs occur again and again:

- the need for *effective* economic solutions in the short-term while moving toward more *efficient* ones over time;
- the tension between the need to achieve tasks *urgently* and the effect such actions (if they bypass local institutions) might have on the government's perceived *legitimacy;*
- the conflicts that can arise between *short-term* and *long-term* objectives; and
- the desire to use the *window of opportunity* to make dramatic economic reforms immediately after the conflict, contrasted with most governments' very limited *absorptive capacity* to manage change.

Pay attention to sequencing: The termination of conflict creates an immediate rebound of economic activity, though typically not to pre-conflict levels. Donor and government consumption of local goods and services stimulates broader economic activity. Job-creation programs generate a temporary upsurge in employment and consumption. Donor and government investments in physical and social infrastructure stimulate demand in the short run and support growth in the medium and long term. Regardless of the effectiveness of donor-financed programs in the short run, however, it is the country's capacity to sustain economic growth that matters most for long-term success.

The highly stylized diagram on the following page illustrates how post-conflict economic growth programming can be approached. Rapid growth requires sound economic policies to be established from the beginning. In the longer term, programs must build the host country's capacity to elicit the self-sustaining growth of a healthy economy. As results are obtained in the immediate post-conflict period, donors should assess which initiatives should shift from an emphasis on effectiveness and short-term results to a more traditional emphasis on economic efficiency and long-term growth. The types of short-term programs that are appropriate for creating jobs and improving well-being immediately following a conflict cannot and should not be funded in perpetuity by donors. There must be the clear prospect of growth through sustainable, productive, private-sector employment to displace short-term donor programs. It must be kept in mind that the patterns shown in the diagram are purely illustrative; a great deal of flexibility must be built into programs to allow them to respond to rapidly evolving post-conflict circumstances.



What should be done?

In the short term: During the early post-conflict period, donors may be required to carry out any or all of the following, to ensure a successful economic transformation and post-conflict recovery:

- Vigorously promote local private-sector participation in relief and humanitarian assistance programs.
- Phase down refugee camps, to encourage displaced families to return to their previous economic activities, except where such activities are no longer economically viable.
- Ensure that the country has a viable currency, accepted for trade and commercial transactions.
- Ensure that the government can make payments and collect revenues. Build the country's capacity to manage its fiscal responsibilities.
- Avoid too much appreciation of the exchange rate, such as that which can result from large donor expenditures, which will reduce the country's export competitiveness.
- Knock down as many obvious barriers to both formal and informal economic activity as possible, as quickly as possible. This could include everything from price controls to unnecessary administrative requirements. Consult widely with both the public and private sectors to understand what needs to be done to unleash economic activity.

- Promote employment generation and stimulate the economy. For maximum effect, do not place undue emphasis on the ultimate sustainability of the activities. The goal is to get labor and capital back to work, and quickly. Employment generation programs should include, but not be limited to, activities targeting ex-combatants.

- Provide grants to a variety of groups, making the time-limited nature of donor funding clear from the outset. Grants may be made to support government-managed public works, for example, and should be made to a wide range of community organizations, businesses, and conflict-affected populations.

- Reduce physical obstacles and eliminate barriers to movement and commerce, particularly for rural and agricultural markets. Promote the flow of market information, and encourage the development of regional and international markets for agricultural products. If needed, remove land mines; make emergency repairs to roads, railways, ports, and airports; restore basic utilities; and establish modern communications systems.

- Establish procedures for handling property and contract disputes, including recognizing customary laws already in use. Establish a transparent, binding process to resolve the claims of former property owners returning to the country, balancing social and political constraints.

- Sell small state-owned enterprises (SOEs) to private investors or subject them to competition. Consider sustaining or restarting some of the operations of larger SOEs, to help generate employment. Avoid large, unsustainable subsidies to large SOEs, however, and introduce measures such as management contracts, hard budget constraints, and competition (when possible).

- Focus on local investment and local employers (and possibly south-south investment) as a source of increased demand. Do not rely on foreign direct investment from developed countries to generate this demand in the short term, because most foreign investors will wait for the risk of resumed conflict to abate before they invest.

- Ensure that basic economic data are collected to monitor economic stabilization and the growth of economic activity.

In the long term: As progress is achieved in each programming area (which will occur at different rates in different areas of activity) donors should shift away from short-term fixes and increase their emphasis on efficiency-enhancing, sustainable increases in productivity, to maximize long-term economic growth. Part 2 of the guide, *Best Practices*, provides specific recommendations for achieving short- and long-term goals—and managing the transitions between them—in each major sector of economic growth activity.

PART I: A NEW APPROACH TO POST-CONFLICT RECOVERY

Forty percent of post-conflict countries return to violence within a decade. In the urgent rush to help, donors do a tremendous amount of good for many people, but nearly half the time they fail to do what is needed to prevent a return to violence.

Evidence shows that early attention to the fundamentals of economic growth increases the likelihood of successfully preventing a return to conflict and moving forward with renewed growth. It is critically important to heed this evidence and make early economic interventions an integral part of a comprehensive restructuring and stabilization program. While economic growth is not the sole solution to resolving post-conflict issues, it can clearly be a significant part of the solution.

I. INTRODUCTION

Bosnia, Kosovo, Serbia, Sierra Leone, Liberia, southern Sudan, Afghanistan, Iraq, East Timor… these are just a few of the many countries in which USAID and other donors have implemented programs in the aftermath of conflict. At times, programs have been carried out in the midst of continuing conflict. Much has been learned from these engagements.

In almost every case, recovery has been slower than desired—transforming and restructuring the economy frequently has taken years longer than imagined. Recent analysis indicates that 40 percent of all post-conflict countries return to violent conflict within a decade.[3] In the urgent rush to help, donors do a tremendous amount of good for many people, but nearly half the time, they fail to do what is needed to prevent a return to violence.

Box 1.1 A New Way of Thinking About Sequencing Economic Growth Activities

In providing assistance to post-conflict countries, there has been a tendency to follow a phased, discrete, and largely non-overlapping sequence of efforts: first, relief and humanitarian assistance are provided; second, soldiers, refugees, and internally displaced persons are reintegrated; third, physical infrastructure is rebuilt; and last, economic reforms are put in place (Haughton 1998). But, as Lewarne and Snelbecker (2004),[1] among others, have argued, following such a model for the rebuilding process may not be sound.

Paul Collier, an Oxford University economist and leading expert on African economies, argues that external peacekeepers and robust economic growth have proven to be more critical than political reform in preventing a return to conflict.[2] Accordingly, many interventions geared to facilitate economic growth can and should be implemented at the very beginning of the rebuilding process. Such an approach may involve early policy reforms in taxes, trade, and foreign investment . It may also include changes in organizational structures, such as strengthening the central bank and reordering other government institutions (e.g., police, courts, or registrars that protect property rights).

The growth rebound following a conflict has almost never been as robust as it could have been, because insufficient attention has been paid to policies and programs that would most effectively accelerate growth and jobs. As a result, living standards have remained low (below pre-conflict levels) longer than necessary. Employment opportunities and improvements in well-being, however, are critically important for people dealing with an uncertain future. The delays, in turn, have reduced confidence in the legitimacy of the terms on which the conflict was ended and have contributed to the likelihood that conflict will resume.

This Guide to Economic Growth in Post-Conflict Countries proposes a different approach. It draws upon lessons learned and reflects a growing consensus that early attention to the fundamentals of economic growth increases the likelihood of preserving peace and moving forward with renewed growth.

By implementing economic growth programs in the immediate aftermath of conflict, donors can better address the underlying causes of conflict and reduce the probability that it will return. The traditional approach follows discrete phases: humanitarian assistance, maintenance of security, and democracy-building, only later followed by economic growth programs. The relief community already has begun to abandon this obsolete "relief to development continuum" concept. This guide urges them to accelerate that change of practice and to rely even more on programs that leverage and strengthen markets while saving lives and alleviating suffering. It also asks economic professionals to accept that short-term

[1] Stephen Lewarne and David Snelbecker, "Economic Governance in War Torn Economies: Lessons Learned From the Marshall Plan to the Reconstruction of Iraq" (report for USAID prepared by The Services Group, December 2004).
[2] P. Collier, A. Hoeffler and M. Soderbom, *Post-Conflict Risks* (Centre for the Study of African Economies, Department of Economics, University of Oxford, 2007).
[3] Ibid.

considerations are immensely important to the success of post-conflict economic growth programs. Distributional consequences must always be a central part of their calculus. All parties, but particularly economic planners, need to develop "conflict-sensitive" programs, taking into account the local political and social context.

The guide is not a checklist. It does, however, provide the basis for practitioners to construct checklists of activities for specific post-conflict situations. Part 1 describes the economic impact of conflict and suggests ways to set priorities for accelerating growth in a post-conflict environment:

- *Chapter II* describes what makes post-conflict countries different from other developing countries, differences that are critical for program content and design.

- *Chapter III* discusses key considerations for economic growth programming, in response to the unique circumstances of specific post-conflict countries.

- *Chapter IV* provides concise, summary guidance on the types of economic growth programs that need to be in place immediately following the cessation of violence and for programs that may follow in later phases.

Box 1.2 Post-Conflict vs. In-Conflict

The body of knowledge about effective economic growth programs and priorities is greater for post-conflict countries than it is for countries in the midst of conflict. Accordingly, more attention is paid to post-conflict countries in the Guide. Nonetheless, it might be possible to base planning for countries in the midst of conlfict on the guidance offered here. After being drawn up, such plans should be revised periodically to reflect the depth of dislocation and destruction from an ongoing conflict. Having such plans in place will facilitate rapid initiation of a post-conflict program.

For countries where an ongoing conflict is limited to specific geographic regions, programs and policy reforms often can be pursued on a national basis, as well as in relatively stable areas not directly affected by the violence. In Colombia, for example, USAID programs have helped achieve more rapid national economic growth. This has created substantial economic opportunities, which have reduced both the incentives for and the feasibility of continuing conflict in the affected regions. Where conflict is largely restricted to part of a country, programs should also anticipate and help facilitate the eventual reintegration of that area and its people into the national economy. (The exception, where devolution is part of the peace agreement, is not addressed here.) In the midst of conflict, it may be difficult to get political support for such programs, but their value will become evident once the conflict is resolved and the rebuilding process is ready to begin.

Part 2 of the guide, *Best Practices*, combines the principles set forth in Part 1 with lessons learned from post-conflict experience, to suggest specific best practice interventions in seven key sectors:

- *Chapter V:* Macroeconomic Foundations
  - A. Fiscal Policy and Institutions
  - B. Monetary Policy and Institutions
- *Chapter VI:* Employment Generation
- *Chapter VII:* Private-Sector Development
  - A. Private-Sector Enabling Environment
  - B. Enterprise Development
- *Chapter VIII:* Agriculture
- *Chapter IX:* Banking and Finance
- *Chapter X:* Trade Policy and Institutions
- *Chapter XI:* Infrastructure

II. THE SPECIAL CIRCUMSTANCES AND CHARACTERISTICS OF POST-CONFLICT COUNTRIES

Context matters enormously when developing immediate, short-term, and long-term programs to promote growth in post-conflict environments. This chapter discusses the key characteristics of countries emerging from conflict and describes the aspects of their economies that are accentuated or caused by conflict.

The characteristics of post-conflict countries are fundamentally different from those of stable developing countries. For this reason, a different approach to programming is required. Standard economic programs, designed to address familiar development problems, often are inappropriate or ineffective in countries emerging from conflict. In these environments, effective programs require an understanding of how economies change during conflict. It also is important to understand what traditional post-conflict recoveries have looked like and why those traditional recoveries have often been inadequate.

Forty percent of all post-conflict countries return to violent conflict within a decade. In the urgent rush to help, donors do a tremendous amount of good for many people, but nearly half the time, they fail to do what is needed to prevent a return to violence.

The economic environment brought about by conflict increases both the costs and the risks of engaging in commercial activity and investing. During conflict, the basis for vibrant private-sector activity and robust growth is eroded. Conflict reduces physical security, drives up inflation, and destroys the value of savings. It threatens the rule of law, reduces the security of property rights, dries up access to credit and financial services, drives away managers and skilled labor, and destroys infrastructure. Conflict also reduces the scope of regulation and taxation, drives economic actors to engage in safer, shorter-term transactions, and rewards activities—many essential but some unsavory—that profit from conflict-driven opportunities.

Economic growth programs must restore confidence by reducing the higher-than-normal costs and lowering the elevated risks of doing business. In designing programs, however, planners face a host of challenges as conflict subsides or is brought to an end:

- significant insecurity
- macroeconomic instability and uncertainty
- reduced rule of law and protection of property rights
- limited access to credit and financial services
- damaged or destroyed infrastructure
- a loss of skills in the private sector and government
- distorted labor markets
- distorted regulation of economic activity
- poor tax enforcement and collection

- a high proportion of informal economic activity

PATTERNS OF POST-CONFLICT GROWTH

The "normal" pattern of recovery after conflict is marked by an initial burst of economic rebound activity but relatively disappointing progress thereafter. One World Bank study[1] analyzed per capita growth rates from 1974 to 1997 in 62 post-conflict countries. It found an inverted U-shaped curve for post-conflict growth. Typically, although growth rebounded in the first two- to three-year "peace-onset" phase, it generally was not above average. Then, in years four through seven, above-average growth rates were achieved. The study states, "We have also found that there appears to be no supra normal growth effect during the first three years of peace, or beyond the seventh year of peace." Even when growth does rebound following a prolonged conflict, it generally takes a decade or more for a country to recover to pre-conflict levels of income and well-being.

There are at least four sources of post-conflict growth:

1) ***Rebound:*** First, economic activity rebounds, due to increased physical security. This rebound is highly visible and involves many new economic actors who were not active during the conflict.

2) ***Donor consumption:*** Second, an increased presence by donor agencies generates demand for local goods and services. This donor consumption stimulates demand for services—such as housing, restaurants, hotels, and dry cleaners—that serve a small, high-income clientele. Donor demand also may increase the cost of local professional expertise and skilled labor, which donor field offices need to operate and carry out programs. This effect can be particularly significant in smaller economies. Although it will stimulate the economy, donor consumption by itself is unlikely to generate long-term, sustained growth.

3) ***Donor investments:*** The third source of growth is the demand generated by donor investments in a wide range of public goods. Investments may range from agricultural rehabilitation and extension programs, health clinics, and schools to large infrastructure projects. A rapid surge in donor consumption and/or investment spending, however, risks increasing the exchange rate, thereby making the country's exports and other traded goods less competitive. Donors and governments must take care to prevent this effect, known as "Dutch disease," from slowing the recovery.

4) ***Self-sustaining growth:*** The final source of growth is the resumption and expansion of interactions among all participants in the economy. This natural, self-sustaining growth is the sign of a healthy economy with a sound policy environment. Ideally, this growth occurs at a significantly faster rate than before the conflict began, due to changes brought about through post-conflict policy reforms and economic growth programs. Regardless of the effectiveness of donor-financed programs in the short run, it is the country's capacity to sustain economic growth that matters most for long-term success and which ultimately permits donors to step aside.

[1] P. Collier and A. Hoeffler, "Aid, Policy, and Growth in Post-Conflict Societies" (Policy Research Working Paper 2902, World Bank Development Research Group, 2002).

KEY COMMON CHARACTERISTICS OF POST-CONFLICT COUNTRIES

Donors face a broad array of common challenges in post-conflict environments. Any or all of the following may be present:

- ***A lack of security:*** The salient characteristic of post-conflict countries, and the factor that affects programming more than any other, is the degree to which there is enough security to move about and interact with the population. There may be different degrees of security in different parts of the country. This may limit the geographic reach of programs and policies during the immediate post-conflict period. It is important to steadily increase the degree and geographic scope of security, not only through policing and the visible presence of armed authorities, but also through political and economic means. This may involve negotiating with aggrieved parties, resolving issues about which groups can exercise authority, and gradually achieving and demonstrating the economic benefits of adhering to the peace agreement.

- ***High unemployment:*** Most segments of the economy rebound quickly and visibly. Construction, in particular, might be booming in the post-conflict capital city. Nonetheless, it is important to remember that it will take many years for economic activity to fully recover to its pre-war level. Thus, unemployment of labor (and capital) may be exceptionally high in relation to pre-conflict unemployment or to levels in similar non-conflict countries. Many of the newly unemployed may be ex-combatants or others who are perceived—due to behavior patterns developed during the conflict—as posing ongoing risks to peace and security. Generating employment is one of the keystones of immediate post-conflict programs.

- ***A need for rehabilitation and replacement of physical infrastructure:*** The country's physical infrastructure is likely to have been significantly damaged, or even carted away in pieces. Frequently, the neglect of basic maintenance is an even greater problem than destruction and vandalism. During a lengthy conflict, a cumulative lack of maintenance results in infrastructure that must be reconstructed because it is beyond salvaging. Of particular interest to enterprises, the electricity grid may have shrunk to a narrow and unreliable core. Roads are likely to be in poor condition because they have not been regularly maintained. Ports and airports often are inefficient and under-maintained; they frequently serve as focal points for corruption. Clinics, schools, housing, and other social infrastructure may have suffered substantially from the need to compete for limited resources. Donors must decide quickly which infrastructure needs emergency restoration and which infrastructure can be rebuilt after lengthier public procurement procedures.

- ***Weak host-government administrative capacity:*** During protracted conflict, many of the most capable government managers—and other educated members of the workforce—flee the country. Most will be slow to return. As a result, the post-conflict government's administrative capacity is likely to be particularly weak. Meanwhile, positive economic results are urgently needed to strengthen the new government's legitimacy and stability. The need to produce quick results may present unusual requirements for donors helping to rebuild basic government functions. Rather than just serving as advisors, donor-funded foreign experts may need to be thrust into line responsibility, actually managing some civilian government functions (as was done in Kosovo). An external military body, such as a U.N.-led military force, may need to serve as the country's primary police force. Donors may need to negotiate with host-government leaders to achieve a working compromise on the division of sovereign authority in some civilian areas. The speed of donor response in the post-conflict period is critical, so donors must accelerate the design of programs and the process of contracting and mobilizing foreign experts.

- ***A disproportionate impact on women:*** Economic disparities for women often increase disproportionately during conflict. There may be a higher-than-usual share of women-headed households, with their corresponding economic hardships. This makes it all the more urgent to include women in transitional employment-generation programs and to improve the enabling environment so that women can work and participate fully in the economy.

- ***The presence of multiple donors and aid organizations:*** There almost always are a large number of donor governments, multinational organizations, and international NGOs on the ground, anxious to start implementing reconstruction and stabilization programs. Each may have different priorities, as well as different views on how priorities should be pursued. It is critically important to establish a process for information-sharing and coordination—both among donors and between donors and the host government—to agree upon policy issues and avoid working at cross-purposes or duplicating efforts. This is easier said than done. Coordination involves agreeing upon a leadership structure and deciding who has the authority to convene a central coordinating body. Donors and host governments also need to establish multiple working groups to deal with the bureaucratic and technical complexities involved in responding flexibly and effectively to a rapidly evolving post-conflict environment. The workload associated with the coordination process often seems overwhelming to understaffed donors and weak host-country administrations, but effective coordination—given the large resource flows in play and the high risks of a return to conflict—is paramount. The critical importance of process issues cannot be overemphasized.

THE POLITICAL AND SOCIAL CONTEXT

Programs to address post-conflict problems must confront as directly as possible the factors that led to the conflict, taking into account the fragility of the political environment. They must be "conflict sensitive" in a way that programs designed in other developing countries are not. Post-conflict countries suffer from the same litany of problems as other countries at comparable income levels, but their problems go much deeper and are in key ways fundamentally different as a result of conflict. Infrastructure maintenance, for example, often is inadequate in developing countries, resulting in high costs or poor service for individuals and enterprises. In many post-conflict countries, however, infrastructure is not just in poor condition—it is nonexistent. It may have been destroyed or not maintained at all during the conflict. In deciding which infrastructure to rebuild, donors and governments need to take into account not only the infrastructure's contribution to the resumption of economic activity, but also the distribution of benefits among parties to the conflict.

Post-conflict countries are also different from each other. How different depends to a great degree on the extent and duration of the conflict and on how it ended. How long did the conflict last? Was it nationwide or more limited in geographic scope? How much damage was done to physical infrastructure and to social and political institutions? How was the conflict stopped? How extensive was the disruption of commerce and general economic activity? What needs to be rebuilt for such activities to resume? What can be replaced with new technologies and practices?

Politics of the conflict

Understanding the politics of the conflict is vital. What fueled the conflict? Did the peace agreement help resolve underlying hostilities or did it postpone dealing with fundamental issues? Does the peace accord open up the possibility of using assistance to address these fundamental issues, or not? How fragile is the peace as a result of whatever accord was reached to stop fighting? What are each side's expectations as expressed in political settlements? How is power to be shared?

Inequity and discrimination

If inequity and discrimination were critical to a conflict, and they almost always are, they will be present in the new government's economic decision-making; they often override considerations of economic efficiency. The issues that led to conflict will always be present, and are often foremost in the minds of the country's political and social leaders. Sources of hostility may be very deeply rooted and therefore very difficult to eradicate. For a Kosovar, for example, the roots of conflict may be traced back 700 years. The new government may not be in a position to mitigate inequity and discrimination, even if it has the will to do so. In the worst case, the government may only pay lip service to issues important to minorities and the political opposition.

Donors need to encourage and promote inclusive national processes and ensure that programs are equitable. The driver of conflict, whatever it was, must be addressed by all aspects of post-conflict programs, and especially by economic planning. As noted by Dr. Richard Caplan, Professor of International Relations at the University of Oxford:

> …economic regeneration is critical for the establishment of a sustainable peace in the aftermath of violent conflict. Economic deprivation can be a source of civil strife, especially in societies where economic disparities coincide with ethnic, religious, tribal or other kinds of social differentiation. Where these disparities have generated frustration severe enough to have led to civil war, it is vital to take measures in the immediate post-war environment to promote economic development that can improve the general welfare and thus weaken the economic foundations of political violence.[2]

Powerful interests

In addition to perceptions of inequity, there is the reality of powerful old interests that may attempt to revive the former social and political structure of the economy, in order to recreate their privileged position. The ownership structure of the economy that existed prior to the outbreak of conflict typically is reinforced by a dense network of personal relationships. If representatives of old interests are present in the post-conflict government, there may be a concerted effort to press donors into financing the rebuilding of old ownership structures, rather than transforming them and subjecting them to competition. A recent report on market development in crisis-affected environments stated that:

> Underlying most market failures are powerful monopolies, only sometimes based on true competitive advantage. More often, they are based on ethnicity, political and family connections, military control, or bureaucratic control, which reaps rewards

[2] Richard Caplan, "The Challenges of Post-Conflict Economic Reconstruction and Development" (remarks delivered at a Chatham House seminar, February 21, 2007).

> for corrupt officials. Market development programs attempt to understand, transform, work around, or confront such powerful market interests to open markets...[3]

To achieve rapid growth while addressing issues of equity and bringing about a structural transformation of the economy, donors must continuously deepen their understanding of the country's political economy.

Planning for economic growth programs must be based on much more than narrow technical considerations of economic efficiency and growth stimulation. It must also be effective at opening up opportunities and increasing inclusiveness. Programs must be judged in part on the basis of whether or not they strengthen one party to the conflict. The ex-ante economic structure should not simply be rebuilt. Are the perceived inequities that led to conflict mitigated or reinforced by the rebuilding program? How can programs increase the perception of equitable treatment for all parties and still be effective in bringing about renewed growth and employment? The relentless pursuit of economically efficient solutions must be tempered by the need to demonstrate fairness and inclusiveness for economically disadvantaged populations, while remaining mindful of the need to move toward economic efficiency to assure sustainability in the long term.

[3] T. Nourse, T. Gerstle, A. Snelgrove, D. Rinck and M. McVay, *Market Development in Crisis-Affected Environments: Emerging Lessons for Achieving Pro-Poor Economic Reconstruction* (Small Enterprise Education and Promotion Network, 2007).

III. POST-CONFLICT ECONOMIC GROWTH PROGRAMMING—SOME FUNDAMENTALS

Economic growth programs must be developed as an integral part of a comprehensive restructuring and stabilization program. The broader program will include investments in political and economic governance, interventions for social services such as health and education, the provision of humanitarian assistance, and the maintenance of peace and security—without which there is little prospect for economic growth.

CLEAR GOALS

Clear goals, an awareness of key themes, and an understanding of recurring trade-offs are important for success. Clear goals are critical, because—in the chaotic circumstances that characterize the post-conflict period—everything seems to be needed at once and there may be many actors with differing priorities. Each post-conflict situation is different, but the following objectives can serve as a starting point for designing economic growth programs:

- reestablish essential economic governance functions and restore the government's legitimacy
- boost employment and improve well-being as quickly as possible
- address the root economic causes of conflict
- stabilize the economy and position it to grow rapidly

SEQUENCING AND PROCESS

Economic growth programs in post-conflict environments, in contrast to those in stable developing countries, require donors to devote significant resources to non-traditional programs and to change how they implement programs, in order to achieve results more quickly. Programs must be developed in a way that takes into account the country's key characteristics. For example, to achieve rapid results in spite of a country's weak institutional capacity, donors may have to become directly involved in repairing and constructing public infrastructure, rather than waiting for multilateral development banks to design and finance such programs. Other examples of how donor processes must adapt to the needs of post-conflict environments are discussed in the next section of this chapter—*Recurring Trade-Offs*.

BOX III.1 LEARNING AND LEADERSHIP

For both donors and government leaders, the learning process—about how rapidly economic reforms can be introduced and what is required for success—will continue throughout planning and implementation.

Following the 1994 national elections in Mozambique, for example, the new Vice Minister of Finance set about reforming the corrupt, inefficient customs administration. She politely turned down assistance offered by donors. A year later, after concluding that unassisted internal reform would not achieve her goals, she obtained assistance from the U.K. to carry out a comprehensive restructuring. Although this effort continued for more than a decade, within two years it produced many of the results the Vice Minister had been seeking.

Collaboration produces sustainable results, but it also requires local ownership, strong leadership, and patience when the reforms are profound.

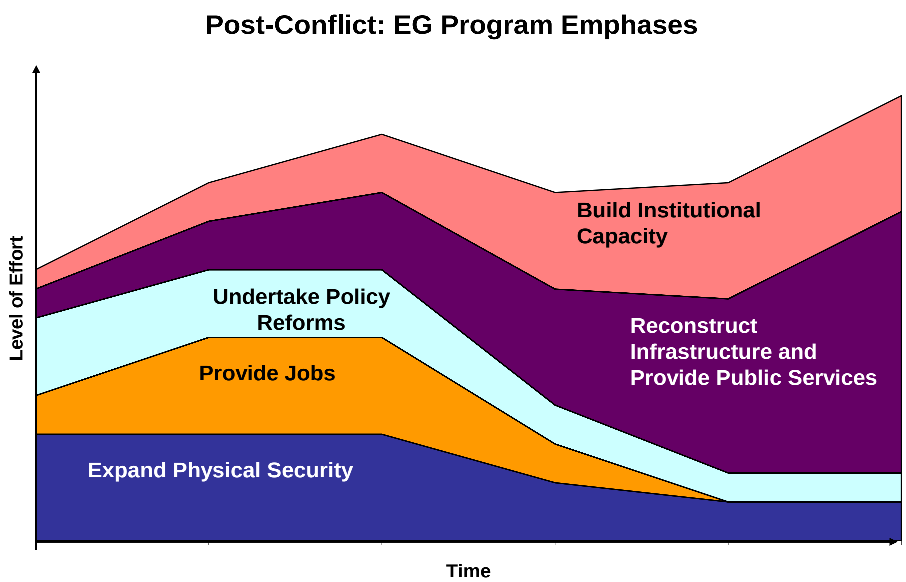
Implementing economic growth programs in post-conflict environments requires much greater attention to process issues than in most developing country contexts. There must be particular emphasis on the quality of coordination among donors and with the host government, which in turn depends on field staff specially trained to deal effectively with post-conflict issues. Time and again, practitioners have pointed out how critical it is to act on the basis of information learned through public–private-sector dialogue. Donors must consult as broadly as possible with all stakeholders, coordinate closely with the government (and in particular with any champions of reform), and communicate clearly and often with the public. To cope with inevitable resistance to change, donors must follow sound change-management practices. Flexibility must be built into programs, allowing them to respond to rapidly evolving post-conflict economies.

Economic policy reforms, small-scale privatizations, market liberalization, and anti-corruption reforms should be pursued vigorously and early in the post-conflict period.

In sequencing interventions in post-conflict countries, donors traditionally have not focused immediately on the reform of economic policies and institutions, but rather on physical reconstruction, human capital recovery, and the social and economic reintegration of former combatants, refugees, and displaced persons. All these are important aspects of post-conflict recovery. However, economic policy reforms, small-scale privatizations, market liberalization, and anti-corruption reforms should also be pursued vigorously and early in the post-conflict period, limited only by the host government's capacity to implement them credibly and effectively. The purpose of this new approach is to bring about:

- a dramatic shift from widespread humanitarian assistance administered by foreign donors to an environment where viable livelihoods are delivered through the private sector
- a transformation of the pre-conflict economic structure through the pursuit of feasible economic policy reforms which will increase both equity and the potential for growth

FIGURE III.1 POST-CONFLICT EG PROGRAM EMPHASES



The highly stylized diagram above illustrates how post-conflict economic growth programming can be approached. Early emphasis should be placed on physical security, without which the likelihood of economic growth is greatly reduced. Donors should immediately and quickly build up programs to stimulate economic activity and generate employment, while continuing to implement security measures. In addition, donors should focus immediately on supporting economic stabilization through improved macroeconomic management; this tactic will yield significant benefits later on. As job opportunities begin to increase—because more employers are offering sustainable, productive jobs—donors should phase down and eliminate their programs for creating economic demand and jobs. At this point, donor initiatives to stimulate private-sector-led growth (which began with pragmatic measures to bring about "quick wins") should turn their focus to efficiency-enhancing programs that will help bring about rapid, sustained growth. By combining a private-sector orientation with policy reforms and programs to strengthen markets, donors can increase prospects for maintaining peace and renewing economic growth. Throughout the post-conflict period, donors should pay close attention to policy reforms, which will increase the chances of success for all programs. It is important to keep in mind that the diagram is purely illustrative, and programming must retain a great deal of flexibility to deal with unforeseen developments and the pace of economic recovery.

Chapter IV contains a more detailed presentation of economic growth programming suggestions.

Recurring Trade-Offs

In post-conflict countries, substantial structural challenges and the ever-present risk of renewed conflict mean that donors need to make decisions quickly, and on the basis of specific trade-offs that are much more acute than in stable developing countries. The key trade-offs that tend to arise again and again are *urgency vs. legitimacy*, *effectiveness vs. efficiency*,[1] *short term vs. long term*, and *window of opportunity vs. absorptive capacity*.[2]

Urgent vs. legitimate

Urgent actions designed to take advantage of an early window of opportunity for reform must be weighed against the effect such actions (if they bypass local institutions) may have on the government's perceived legitimacy. Mistakes will be made in judging among all the proposals for urgent action, but there should be due consideration of each action's effect on legitimacy. To illustrate this point, consider the passage of a new company law in the belief that it is needed to encourage business activity and investment. Donors might believe that such a law needs to be promulgated quickly, even before a parliament has been formed or even if it means pushing an imperfect law through parliament. If the law is not widely seen as legitimate, however, doing so could weaken the credibility of the government. In one such case, prior consultation with the intended beneficiaries of this law might have revealed how unnecessary this step actually was in practice.

Effective vs. efficient

Effective, immediate solutions are not always efficient, but may be important in some situations. In post-conflict settings, there often is not time to await the benefits of economically efficient solutions or arrangements, because results must be achieved very quickly to mitigate the risk of instability and a return to conflict. A clear illustration of this trade-off is the role of informal activity, which is likely to have

[1] *Effectiveness* can have different meanings in different contexts. Here it means doing what works without regard to its sustainability or economic cost. *Efficiency* here follows the economic definition, meaning that which will cost society least in the long term.

[2] While there often is overlap and these categories are not mutually exclusive, each of these trade-offs makes a useful distinction in practice.

increased dramatically during a conflict. Most post-conflict governments, however, want to clearly establish their authority over economic actors. Their first instinct may be to limit informal activities, particularly where they compete with state-regulated industries. In general, however, governments should not seek to discourage informal enterprises in the aftermath of a conflict. If, for example, the national power grid has collapsed, small private electricity suppliers may be meeting the needs of residential and small-business consumers. Although these informal suppliers are both costly (economically inefficient) and not legally constituted enterprises, the effective policy is to permit them to continue to provide electricity as long as their services are in demand. This principle applies to almost all post-conflict informal-sector activity, with the exception of clearly criminal activities.

Short term vs. long term

Donors must be careful to prioritize short-term vs. long-term programmatic needs. Post-conflict environments require extensive reforms, but do not require all of them immediately. For example, foreign direct investment is tremendously important for a country's long-term economic growth. In the short term, however, it generally is counterproductive to devote significant resources to attracting foreign investors, who are unlikely to enter the market before investment conditions justify it. They may have deep pockets and bring new technologies and markets, but foreign investors typically are less willing to risk their capital than local investors, and often are less well-informed about the true investment risks in a post-conflict situation. In addition, devoting resources to attracting foreign investors would divert government attention from the most likely providers of early investment and jobs—local investors and employers (and possibly south-south investors). In the short term, the government needs to take pragmatic steps to stimulate demand and create jobs, rather than focusing on a long-term payoff from foreign investment.

Window of opportunity vs. absorptive capacity

In considering this trade-off, donors should be very selective, introducing a set of changes that will produce positive effects without overwhelming the government's capacity to manage change or society's capacity to absorb it. The window of opportunity vs. absorptive capacity trade-off will arise immediately with a large number of proposals for change, requiring donors to exercise judgment along several dimensions. At the end of a conflict, a break with the past frequently opens a window of opportunity for reform. There is a chance to introduce new, improved practices and to change economic governance structures as a new administration takes office. Although many "stroke-of-the-pen" liberalizing reforms require little or no absorptive capacity, there are also many policy, procedural, and technological changes which—while highly desirable—require the government and civil society to have substantial technical and institutional capacity. In evaluating the trade-off between a window of opportunity and absorptive capacity, donors must judge whether the country's institutions, leaders, managers, and human resources are willing and able to implement and manage change.

In some cases (as is argued in Chapter IX: Banking and Finance) older "tried-and-true" methods will more readily restore the functioning of the economy or of a specific sector than better or more modern methods, because of the time required to train everyone in the new system. In other cases, a modern system is so superior to an older tried-and-true system that the payoff from reforms and restructuring makes it worth the investment. Examples of this principle include the use of information technology in financial management systems (which can also be a useful tool for limiting corruption) and the leap to cellular telecommunications instead of restoring and relying on landlines.

The second part of the guide, *Best Practices,* includes many more examples of trade-offs as they pertain to specific sectors. It also provides guidance on dealing with these dilemmas in a post-conflict setting.

IV. DECIDING WHAT TO DO WHEN – PRIORITIZATION AND TIMING

Each post-conflict situation is unique; there can be no single checklist for all situations. Nonetheless, there are key elements that need to be included in most post-conflict strategies. This chapter discusses those elements and describes the importance of conducting a rapid assessment, which is needed to set more detailed priorities. It also provides broad guidance on the types of programs that are appropriate during the immediate post-conflict period (usually two to three years in length) and those needed during later phases. This chapter will help planners verify the degree to which their programs (along those of other donors) address the fundamental economic issues.

Donors' task is to simultaneously bring about stability, a recovery of basic economic activity, and a structural transformation of the economy that will mitigate the economic factors underlying the conflict and position the economy to grow rapidly.

Post-conflict work is commonly referred to as "rebuilding," but this term may create the mistaken impression that the idea is to put things back the way they were. It is important to keep in mind that the way things were contributed in some way to violent conflict. Accordingly, donors' task is to simultaneously bring about stability, a recovery of basic economic activity, and a structural transformation of the economy that will mitigate the economic factors underlying the conflict and position the economy to grow rapidly. Planners should not underestimate the challenges of doing all this effectively, but know that it can and has been done successfully before.

RAPIDLY ASSESSING ECONOMIC CIRCUMSTANCES

Time may not permit thorough analysis, but a rapid assessment of a post-conflict country's circumstances and characteristics is a vital early step. In the aftermath of a conflict, programming should start immediately. Because there is not time to conduct the detailed—but time-consuming—analysis that is a prerequisite for programming in stable developing countries, assessments to inform programming must be done rapidly. In designing economic growth programs, donors need to address a number of key questions. How badly has conflict disrupted commerce and productive activity? Are markets functioning? If not, what is preventing a resumption of market activity? Are some markets missing altogether?

Informal assessments, based on consultation with a wide range of economic actors, can provide vital information about what needs to be done early on. If a lack of physical security for expatriates limits mobility, donors can develop systems that rely on local employees and organizations. Business people and informal entrepreneurs, in particular, can report on developments in local markets and provide regular information on attitudes, prices, and the availability of goods and services. To understand developments in the economy, frequent interaction with local economic actors is strongly encouraged.

Assessments should include basic information about the state of the economy, in addition to extensive informal consultations and data gathering. This information should be related to the causes of conflict. Rapid assessment tools are available from various organizations. The 2005 USAID publication "Conducting a Conflict Assessment: A Framework for Strategy and Program Development" is particularly helpful. "Post-Conflict Reconstruction: ESSENTIAL TASKS," a document developed by the U.S. Department of State's Office of the Coordinator for Reconstruction and Stabilization, provides a comprehensive indicative list of tasks, including assessment tasks, in matrix format. This list is a valuable guide to the issues that need to be considered when developing post-conflict economic growth programs. Because the range of recommended tasks is extensive, a short-list of country-specific priorities will have to be determined.

Box IV.1 Using Informal Assessments

Mozambique in the mid-1980s followed a Soviet-inspired regime of price controls. In this environment, there was almost no incentive for potential vegetable producers to supply the Maputo market. Every day, customers formed long lines to access the limited supply. There was no need for formal studies to understand the market failure in this situation. It was also easy to observe that there was no market for vegetable seed supplies and small tools.

The USAID Mission agreed to finance an initial supply of seeds and tools if the government would abolish price controls on vegetables. Once this happened, the vegetable market flourished in short order, with increasing amounts and varieties of vegetables. Input supply markets soon followed.

As the rapid assessment is being carried out, donors can begin to identify and prioritize needed interventions. The next section of this chapter lists typical interventions required in the immediate post-conflict period. It is followed by a list of requirements typical during a program's later phases.

Typical Requirements in the Immediate Post-Conflict Period

Based on priorities identified by the rapid assessment, donors might be required to carry out some or all of the following to ensure a successful economic transformation and post-conflict recovery:

- ***Vigorously promote local private sector participation*** in relief and humanitarian assistance programs.

- ***Phase down refugee camps*** to encourage displaced families to return to traditional economic activities and to rural employment (if such activities remain economically viable), thereby reducing the population of idle, unskilled workers in urban areas.

- ***Ensure that the country has a viable currency,*** accepted for commerce and trade. This can be an international currency until the country once again has the capacity to manage its own.

- ***Ensure that the government can make payments and collect revenues.*** Rely on easily administered taxes and customs duties at first. From this base, immediately begin to build capacity to manage the money supply, oversee financial institutions, and manage the central government budget. If external debt discourages investment, negotiate debt forgiveness and rescheduling. Seek to achieve fiscal discipline as quickly as possible.

- ***Avoid too much appreciation of the exchange rate,*** such as that which can result from large donor expenditures, which will reduce the country's export competitiveness and harm its potential growth from export development. This important but complex macroeconomic management issue may require specialized assistance from economists.

- ***Knock down as many obvious barriers to both formal and informal economic activity as possible,*** as soon as possible. Such barriers may include price controls, onerous business registration procedures, or restrictions on who is allowed to apply for import licenses. Consult widely with both the public and private sectors to understand what needs to be done to unleash economic activity. Do not limit consultation to formal-sector actors only, since they may be seeking to curb competition. Include small farmers and private-sector agricultural interests, to identify any special barriers to agricultural activity.

- ***Promote employment generation and stimulate the economy.*** While increased donor consumption alone will provide a certain amount of stimulus, immediate, broad-based impact requires a quick increase in donor-financed investment. At the outset, for maximum effect, donors should not be unduly concerned about the ultimate sustainability of the activities. The goal is to get unemployed labor and capital back to work, and quickly. Although sustainable investments are always preferable, time constraints and inadequate data may not permit a careful assessment of all proposed activities. Employment generation programs should include, but not be limited to, activities targeting ex-combatants.

- ***Provide grants to a variety of groups***, making the time-limited nature of donor funding clear from the outset. Grants may be made to support government-managed public works, for example, and should be made to a wide range of community organizations and businesses. Distribute cash to conflict-affected populations, provide seeds and tools to farmers, or promote seed fairs and tool fairs to facilitate the return of displaced persons and refugees to their farms.

- ***Reduce physical obstacles and eliminate barriers to movement and commerce,*** particularly for rural and agricultural markets. Promote the flow of market information and encourage the development of regional and international markets for agricultural products. If needed, remove land mines; make emergency repairs to roads, railways, ports, and airports; restore basic utilities; and establish modern communications systems to provide timely information about market conditions.

- ***Establish procedures for handling property and contract disputes,*** including recognizing customary laws already in use. This will facilitate the return of displaced persons and refugees to their land to rapidly resume agricultural production. Establish a transparent and binding process to resolve the claims of former property owners returning to the country, balancing social and political constraints. Establish alternative dispute resolution mechanisms to adjudicate contract disputes without recourse to a full court procedure. As soon as possible, begin a national dialogue about disputed or unclear property rights that pose a serious obstacle to the resumption of economic activity.

- ***Sell small state-owned enterprises (SOEs)*** to private investors or subject them to competition. The complexity of preparing large SOEs for sale is likely to exceed host-country capabilities. Consider sustaining or restarting some of their operations on an interim basis to help generate employment.[1] Address the privatization of large SOEs at a later stage. In the interim, if

[1] One author argues that "Foreign actors should therefore seek to limit large negative shocks to employment following the cessation of formal fighting and consider policies that move resources out of unproductive sectors gradually rather than suddenly. This means that such policies as SOE privatization and bureaucratic overhaul may have to be longer-term goals, while in the shorter term, security should remain the priority." William Butterfield, *The Role of Foreign Actors in Supporting Economic Growth and Liberal Democracies in Post-Conflict Countries: Why Efforts May Fail* (2007).

government capacity permits, introduce temporary measures such as corporatization, management contracts, or hard budget constraints to curb the excesses of SOE management. Encourage the private sector to take market share from SOEs as state subsidies are gradually phased out. Reduce the tariffs on imports that compete with SOEs' products.

- ***Focus on local investment and local employers*** (and possibly south-south investment) as a source of increased demand. Do not rely on foreign direct investment from developed countries to generate this demand in the short term,[2] because most foreign investors will wait for the risk of resumed conflict to abate before they invest.

- ***Ensure that basic economic data are collected,*** to monitor economic stabilization and the growth of economic activity. This initiative is vitally important for determining future directions.

Typical Requirements In Later Phases

Since not all initiatives achieve results at the same rate, the later phases will be entered more quickly in some areas of activity than in others. It is important for donors to maintain as much flexibility as possible, so they can respond to different rates of change and to the contingencies that inevitably arise after a conflict.

In setting priorities, donors must continue to apply a "conflict lens." It is important to recognize that for at least a decade after a conflict has been resolved, the country will continue to face a significant risk of returning to hostilities. As program decisions are made, the government or other authorities should be encouraged to continue maintaining and expanding the geographic scope of physical security, which is critical to the growth of economic activity.

The host country should develop a strategic framework to guide policy formulation and the choice of programs during this phase. This task, under host-country leadership and in coordination with the donor community, will ensure that there is a common understanding and agreement to work within the country's own framework. An economic growth program defined by the strategic framework may require donors to support some or all of the following initiatives:

- ***Strengthen the major institutions of economic governance.***

- ***Build the capacity of the tax and customs administrations and introduce reforms in the tax structure.*** Tax reform should include simplifying the tariff structure and broadening the tax base. If there is widespread corruption in the tax and customs administrations, carry out systemic reforms and changes in personnel to increase efficiency and fairness.

- ***Strengthen budget execution and budget planning functions***, including the capacity to interact productively with the parliament.

- ***Build the capacity of the central bank*** to implement monetary policy and to oversee banking institutions. Audit commercial banks and strengthen bank supervision. Establish a sound policy framework and modern oversight structures for microfinance institutions. Build capacity within the financial sector.

[2] There are some limited exceptions to this recommendation, discussed in the second part of the guide: *best practices.*

- ***Strengthen economic data collection and conduct a national population census.***
- ***Phase out job-creation programs that would distort labor markets.***
- ***Improve the business climate by establishing accepted measures of performance*** (such as the *Doing Business* indicators[3]) as benchmarks for progress. Increase the availability of market information. Support an expanded private–public-sector dialogue, building on the consultations begun during the immediate post-conflict period. Reduce costs and increase incentives for informal enterprises to voluntarily become formal.
- ***Build a national consensus for a more open economy*** to benefit from trade and encourage full participation in regional (multicountry) customs, unions or trading areas. Build the country's capacity to analyze trade issues and participate in the World Trade Organization.
- ***Revise and strengthen laws concerning property rights,*** using a national consultative process.
- ***Continue to place a priority on infrastructure*** that supports greater private-sector economic activity. Increase the proportion of investments in infrastructure that meets standard benefit-cost criteria. However, continue to be conflict-sensitive when selecting investment projects, to ensure broadly distributed benefits. Build public institutions' capacity to analyze investment proposals, conduct the procurement process, and manage and maintain major infrastructure. As much as possible, encourage private-sector management of infrastructure construction and operation.

Part 2, *Best Practices,* combines the principles described in Part 1 with lessons learned from specific post-conflict experiences. It provides much more detailed programming suggestions for key sectors, as well as information about assessment tools and reference documents to assist in carrying out program designs.

[3] World Bank, *Doing Business 2007: How to Reform* (2007).

PART 2: BEST PRACTICES

The empirical record shows that the private sector provides the main thrust for economic growth. The government, however, also plays a fundamental role in creating an environment where entrepreneurial drive, innovation, and investment can be translated into long-term growth. Successful economic-growth interventions in post-conflict countries require donors to

- help the host government ensure that it has control over state revenue and expenditures to provide essential services for the public, thereby enhancing its legitimacy;
- help create a friendly policy environment for enterprises, an environment that will allow them to generate and retain earnings, invest their own and borrowed resources, and grow;
- support cost-effective programs for employment and income generation; these programs must be conducive to building community action and repairing infrastructure, but must not disrupt the revival of private entrepreneurs and markets;
- mobilize resources quickly.

V. MACROECONOMIC FOUNDATIONS

Overarching objective: *rein in inflation and preserve price stability*

Because inflation—especially at high rates—deters business investment, erodes the value of family savings, and can weaken or stall economic recovery, a central objective for fiscal, monetary, and exchange-rate management is to rein in inflation and preserve price stability. Host governments must regain control over state revenue and expenditures, and over the management of monetary and exchange-rate policies. In the post-conflict environment, some basic policy and related institution-building interventions are needed to ensure this control and maintain price stability. These interventions cannot be merely short-term undertakings. In their 2004 survey for USAID, entitled "Economic Governance in War Torn Economies," Lewarne and Snelbecker concluded:

> In almost all reconstruction efforts, the task of creating new [monetary and financial] institutions has turned out to be harder and more time-consuming than expected.

Fortunately, the main levers of monetary and financial stability usually fall within the post-conflict government's initial "zone of control "—the capital city and the main commercial trading centers—allowing monetary and fiscal assistance to be started early. Even in these centers, however, the host government's policy and administrative structure is likely to be weak, with a small number of highly effective ministers at the top and a very thin cadre of skilled technical managers in key economic ministries.

The IMF and the World Bank normally take the lead in carrying out initial assessments and providing short-term advice on rebuilding the host government's basic fiscal and monetary management capacity. In addition, they usually lead efforts to improve the accuracy and collection of the financial and statistical information needed to monitor the condition of the economy.

The IMF's early technical assistance typically includes a diagnosis and recommendations for improving monetary management or tax policy and administration. Such assistance usually is short term and takes place during intermittent visits, because the IMF has a lower worldwide ceiling for funding long-term technical assistance than do multilateral development banks and bilateral donors. This leaves the IMF with little "surge capacity" to carry out capacity-building programs in post-conflict states.

The World Bank is likely to offer greater long-term resident assistance, particularly for public-expenditure management functions. With some exceptions, however (such as the Bank's quick response in Liberia since 2005), the multilateral development banks are slow to assess, approve, and mobilize relevant experts.

In most cases, USAID, DFID, and a few smaller bilateral donors have been able to more quickly mobilize the type of substantial, long-term resident technical assistance needed to rebuild the capacity of fiscal and monetary institutions.

A. FISCAL POLICY AND INSTITUTIONS

> ***Overarching Objective:*** *put the host country on a path to greater budgetary self-sufficiency*
>
> *High levels of donor assistance (often totaling more than 20 percent of GDP during the initial post-conflict years) are not likely to be sustainable in the longer term. To adjust to this external financial reality, the host government must be able to adequately mobilize "own revenue" and soundly manage expenditures.*

POLITICAL AND SOCIAL ISSUES

Prolonged conflict typically decimates a government's ability to collect revenue. In a few post-conflict countries, such as Colombia and Lebanon, the main public revenue collection mechanisms that existed prior to the conflict may be functioning and largely intact. In most cases, however, raising enough funds to cover the public payroll is an immediate challenge. Reviving or developing tax collection mechanisms then becomes a high priority. These mechanisms must produce adequate revenue, taking into account the minimal administrative capacity that may exist. Both tax policy (revised tax laws) and tax administration mechanisms are likely to need modifications. These modifications should be designed to 1) minimize distortions to the enterprise sector, 2) be seen as fair and reasonable by the public, and 3) be within the capacity of the tax administration to manage well.

During the conflict, two parallel systems often evolve for payment of public services (many of which may have been severely eroded or may even be nonexistent). The *host government budget* funds ministerial payrolls and other recurrent expenses under the government's control. *Donor budgets* fund most capital projects and a wide array of services. Donor-funded services may range from security (peacekeeping forces under international authority) to technical assistance and equipment for line ministries. Through international NGOs, donor budgets may also fund village-level welfare and enterprise development activities.[1]

KEY TRADE-OFFS

In post-conflict countries, substantial structural challenges and the ever-present risk of renewed conflict mean that donors need to make decisions quickly, and on the basis of specific trade-offs that are much more acute than in stable developing countries. In providing fiscal management assistance, the key trade-offs are *effectiveness vs. efficiency*, *urgency vs. legitimacy,* and *short term vs. long term*.

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[1] One Liberian government official noted in 2005 that the collective budgets of all of the foreign NGOs in Liberia exceeded that of the national government.

Effective vs. efficient

Early in the post-conflict period, the host government's capacity to collect import tariffs and excise taxes is usually stronger than its capacity to collect sales and income taxes. For this reason, the most effective strategy may be to maintain an initial structure of broad-based import tariffs coupled with a modest number of excise taxes. In the longer term, however, economy-wide sales taxes such as VAT (the most efficient type of tax for most developing countries) and income taxes are more efficient; the country will need to shift its emphasis accordingly.

Import tariffs should be applied at a uniform rate across all consumer and capital goods, as was done in Kosovo. Excise taxes should cover both imported and locally produced products, and are most effective when applied to products such as alcohol and fuel, whose entry into the market can be readily monitored, either at the port or *ex fabrica*. The country also may need to impose an export tax on one or two traditional exports in which it has a strong comparative advantage (such as tropical timber in Liberia) until other, more management-intensive royalty and tax regimes can be introduced.

Urgent vs. legitimate

If sufficient own revenue and donor grants are available, the host government may want to ramp up expenditures quickly to meet urgent needs for public services. Execution by the host government lends greater legitimacy to the budget-spending process. Government-procured services also may be less expensive than services provided by foreign NGOs and donor contractors.

The host government's capacity to manage the spending process efficiently and with integrity is likely to be weak. In Liberia, for example, more than a year after the January 2006 installation of the Sirleaf government, the U.S. Embassy reported that—although budget execution had definitely accelerated—two important obstacles remained. First, expenditure requests were submitted late and appropriations approved late because the government lacked the capacity to prepare vouchers, procurement requests, and other documents needed to justify expenditures. Secondly, complying with the country's Procurement Act remained a challenge. This challenge was cited as the principal reason for the gap between revenue collection and expenditures.

Short term vs. long term

The sequencing of new procedures and technology must be carefully considered. In particular, the appropriateness of tax policies must be assessed before tax administration and collection systems are modernized. In Bosnia, for example, the donor community committed a major error by prematurely modernizing the administration of a tax system that was based on pre-conflict tax policies that burdened and distorted private business operations.

During the early and middle post-conflict years, a short-term reliance on revenues from border taxes or other simple taxes (such as excise taxes) is likely to be both necessary and appropriate. There are, however, two important qualifications:

- To complement improved policies and administration for border and excise taxes, there should be a review of the legacy system for direct taxes, especially corporate income and payroll taxes. Parts of the direct tax regime may need to be amended or scrapped. This may be likely, for example, if the pre-conflict tax regime was highly punitive against law-abiding businesses (as in the Balkans during the 1990s) or if corruption (side-payments) among administrative staff is too difficult to curb.

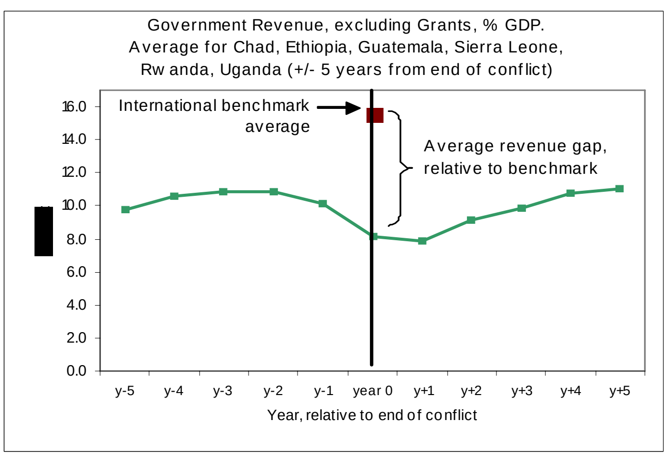
- Reliance on border taxes does not imply the use of simple or manual methods for assessment and collection. In a number of post-conflict countries, such as Kosovo and Liberia, the use of Internet and electronic methods to verify, value, and collect import tariffs and other taxes has proven to be both feasible and important during the early stages of rebuilding fiscal capacity.

In the early phase of recovery, it often is important to help the host government identify and eliminate ad-hoc tax exemptions and improper waivers for importers. These exemptions, not expressly provided by law or treaty, often have become widespread during the conflict, facilitated by illicit side payments. In later phases of recovery, maintaining a firm policy against tax exemptions and "incentives" will remain important. A broad, uniform definition of the base for tariffs, VAT, and income taxes allows tariff and tax rates to be set and kept low. It also reduces opportunities for evasion and corruption, which are inherent in all systems offering multiple rates and exemptions.

In the longer term, sales or value-added taxes and income taxes will become a priority. As the country's capacity for tax administration improves, collecting sales or value-added taxes and corporate and personal income taxes (withheld by formal-sector employers) will be emphasized. Taxpayer self-assessments will become increasingly important during this phase, as sophistication and recordkeeping improve. Later, a form of VAT is likely to become the largest revenue source. As revenue from sales or VAT taxes and income taxes grows, authorities will be able to reduce tariffs on imports (to, for example, a 10 percent uniform rate). This will reduce incentives for smuggling and false invoicing, and will promote the development of internationally competitive export and import-competing industries. Broad income taxes are the most difficult to administer effectively and fairly.

In most cases, the host country's ability to mobilize revenue other than border taxes evolves very slowly. Figure V.1 shows the pattern of revenue recovery for six countries that have full data for five years before and after the end of a high-intensity conflict (as identified by the University of Maryland's political violence analysis). On average, the ratio of domestic revenue to GDP starts to increase one year after the conflict ends and climbs by nearly three percentage points by year five. Even in year five, however, the revenue yield is quite low, averaging 11 percent of GDP. By comparison, the revenue yield by their international peer group (calculated by income group for each country at the time the conflict ended) averaged 15.5 percent of GDP.

FIGURE V.1 GOVERNMENT REVENUE AS A PERCENT OF GDP



Source: Nathan Associates' calculations from Country Analytical Support Database

In the short term, in tandem with attention to fiscal revenues, the authorities and the international community must determine whether the budget process works and whether the administration of public expenditures is operational and effective. Early donor support for budget execution and planning is likely to be required, with an emphasis on creating a single, consolidated set of **Treasury** accounts and establishing an expenditure management system under the auspices of the Ministry of Finance.

Longer-term priorities for managing government spending include subjecting the budget to independent checks. Although it eventually will be important to ensure that the budget is overseen in an effective manner by the legislature and that it is audited by a national watchdog agency, these independent checks may not be feasible or reliable in the short term.

PROGRAMMING OPTIONS

Donors should seek to shift political authority, budget authority, and financial responsibilities from donor mechanisms to the host government's own budget as fast as possible, although in reality this process generally takes many years. This shift is important for national pride; it also may reduce the unit costs of providing public services. It is vital, however, to ensure that public financial management systems are efficient and able to protect public resources from abuse and corruption.

Collaboration between donors and the host government produces sustainable results, but requires local ownership, strong leadership, and patience when the reforms are profound. Generally, the host government will recognize the need for—and be receptive to—donor assistance with revenue collection and expenditure management systems. In some cases, however, the government may not truly want to introduce new procedures and controls, which may in some areas conflict with personal prerogatives customarily available to government leaders. Just such a situation arose in Liberia in 2004 – 2005, when donors sought to impose controls over unprogrammed budget allocations for "travel expenses" by various ministers and ministries under the National Transitional Government.

Host-country leaders' desire for ownership of reforms can also be an obstacle to donors' offers of badly needed assistance. Following the 1994 national elections in

BOX V.1 FISCAL DECENTRALIZATION

In post-conflict countries, creating and supporting independent, sustainable local governments may help reduce conflict. If the opposition and minorities have a real stake in the country's governing structures, this may be sufficient incentive to deter them from returning to conflict. Frequently, independence movements' key demand is for autonomy with sufficient financing (either from taxes or a share in natural resource earnings) to carry out government activities. If the central government devises a way to satisfy demands for local autonomy, it may well help mitigate conflict and sustain peace.

In practice, creating independent, sustainable local governments has proven to be difficult. Central governments have faced issues such as:

- unacceptably high levels of corruption in local government
- difficulties in devolving independent revenue sources to local governmentsbecause of resistance from international financial institutions
- inadequate capacity to raise revenues to finance decentralization, given other pressing priorities
- technical problems in devising successful means of finance
- concerns that financially autonomous local governments may act in ways that adversely affect the finances of the nation as a whole
- tensions with NGOs that wish to take the lead in delivering key services
- inability of independent local governments to maintain national standards for service delivery.

In post-conflict countries, the case for creating or supporting independent, sustainable local governments is primarily based upon the effectiveness of this approach in reducing conflict, not on its prospects for increasing economic efficiency in the use of public resources. In Indonesia, the use of the tools of fiscal federalism was highly successful (along with other significant factors, such as post-Tsunami relief) in helping reduce or mitigate conflict in Aceh, previously a breakaway province.

Mozambique, for example, the new Vice Minister of Finance embarked upon a reform of the corrupt, inefficient customs administration, politely turning down assistance offered by donors. A year later, she concluded that unassisted internal reform would not achieve her goals. She obtained assistance from the U.K. to carry out a comprehensive restructuring; within two years, this effort produced many of the results she was seeking.

In most post-conflict situations where the U.S. government has played a leading role in rebuilding fiscal institutions (e.g., El Salvador, Bosnia, Kosovo, Afghanistan, and Liberia after 2005), authorities have accepted or even embraced donor involvement in thoroughly reforming their policies, systems, and capacity to implement tax and spending functions. Based on these cases, as well as other USAID experiences, Gallagher (2007) has suggested the following sequencing for donors' fiscal capacity-building.

TABLE V.1 FISCAL POLICY AND INSTITUTIONS PRIORITY AND SEQUENCING OF ASSISTANCE

Item	*Urgent*	*Immediate*	*Intermediate*	*Consolidating*
Expenditure control	High-intensity	High-intensity	Lower-intensity	Lower-intensity
Receipts management	High-intensity			
Indirect (tariffs, excise, sales) tax control	High-intensity	High-intensity	Lower-intensity	
Direct (income and payroll) tax control		High-intensity	High-intensity	Lower-intensity
Fiscal policy planning and management capacity	Lower-intensity	Lower-intensity	Lower-intensity	Lower-intensity
Economic and fiscal statistics		Lower-intensity	Lower-intensity	Lower-intensity
Reform of tax policy		High-intensity	High-intensity	Lower-intensity

High-intensity level of assistance | Lower-intensity level of assistance | No assistance during phase

On the revenue side, the aims are to achieve business-friendly systems, reduce transaction and compliance costs, and curb corrupt behavior by tax officials. Donors frequently focus on the design and administration of customs, excise, VAT, and income tax systems. If customs is the first priority for revenue reasons, a balance is needed between taxing all imports effectively and making traders' administrative burdens as simple and predictable as possible. (See Chapter X: Trade Policy and Institutions.)

On the expenditure side, the efficiency of government spending needs to be improved. A number of practices and procedures are important in achieving this efficiency:

- *Improved government treasury operations:* As soon as possible, a payroll system should be established that helps remove ghost employees and channels as many payments as possible through the banking system. When feasible, an integrated financial management system (such as those which USAID successfully helped set up in Bosnia and Kosovo) should be implemented.

- *Better budget preparation and planning:* An annual budget should be prepared that reflects the realistic needs of the line ministries. A structured process for reshuffling budget allotments during the year, to reflect actual revenue availabilities or changes in budget priorities, will also be needed.

- *Financial discipline for state-owned enterprises:* This may be a high priority in countries where state-owned infrastructure and enterprises have been major conduits for waste and corruption and have become a drain on the public treasury. In some politically robust environments, donors may have authority to impose greater discipline directly, either as interim managers (as in Bosnia and Kosovo) or within the framework of a donor–host-government financial control pact (as in Liberia). In other post-conflict states, especially those with socialist traditions and those where SOEs dominated the landscape and represented major sources of employment, a more indirect approach may be needed.

  Sustaining employment and averting social unrest do not necessarily require high-cost government subsidies (such as the subsidies given in Kosovo to the electricity monopoly KEK and the mining conglomerate TREPCA). The most straightforward solution for continuing to operate SOEs under state management while restraining subsidies is for the government to impose a "hard budget constraint."[2] Such a constraint limits an SOE's outlays for wages, materials, and investment to the cash flow that the enterprise can generate and to the credit its bankers and creditors are willing to supply against its business plan.

- *Development and approval of a public-sector investment budget:* The budget must be subject to central review to ensure proper prioritization, cost-benefit analysis, and attention to future recurrent costs, as well as appropriate cost-recovery mechanisms and policies. Tendering should be subject to central procurement policies and to cross-checks that reduce corruption.[3] (See also Chapter XI: Infrastructure.)

- *Budget execution and audit:* Effective monitoring and control procedures for expenditures and an independent, trustworthy audit agency need to be built. These measures can help ensure that funds get spent for the purposes stated in the budget plan, and that audits are conducted, which will lead to identification, discouragement, and successful prosecution of financial misconduct by public officials.

AVAILABLE RAPID ASSESSMENT TOOLS

Assessment assistance is available from USAID's Office of Economic Growth (EGAT/EG) and from a fast-reaction contracting mechanism that provides assistance for fiscal reform and economic governance. (USAID personnel see http://inside.usaid.gov/eg/contract_grant_svcs.htm#list_of_mechanisms.)

[2] See, for example, the recommendations in Moala-Fetini and others, *Kosovo: Gearing Policies Toward Growth and Development* (2005), p 27.

[3] Even before local authorities take charge of major capital investments, donors need to cooperate on capital budgeting. As noted by Lewarne and Snelbecker (2004) in their review of the early post-conflict period in Afghanistan: "Specific capital construction projects pushed by individual donors should be funded and phased through the fiscal authority so that there is not a separation of the current and capital budget. This was one of the main mistakes made by the European Agency for Reconstructions (EAR) and UNMIK in Kosovo, and one of the strengths of the National Development Framework (NDF) in Afghanistan." Pp. 98-99.

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B. MONETARY POLICY AND INSTITUTIONS

It now is widely accepted that inflation, especially at high rates, deters business investment and weakens economic growth. In many post-conflict countries, one important early challenge is to overcome inflation (or even hyperinflation) and preserve price stability. A second major challenge is to restore or shore up the currency and payments system, which provides a medium for transactions and a store of value for the public.

> ***Overarching Objectives:***
>
> - *help monetary authorities control the money supply and credit growth, in ways consistent with price stability*
> - *develop a government payments system that minimizes the use of cash transactions*
> - *provide the private economy with a local currency*
> - *support other components of the private payments system*

Political and Social Issues

A key political issue faced by most post-conflict countries is the need to establish an appropriate degree of policy independence for the central bank. Over the past 50 years, the model of constitutional or statutory independence for the central bank—with a long, secure term of office for the central bank governor—has become accepted around the world. This institutional approach gives the central bank the authority to restrict or limit the government's access to credit from the banking system, thus curbing this potential key source of inflation.

In some countries, the basic legal principles of central bank independence may need to be introduced. In others, the challenge is to select a strong central bank governor and to help government leaders understand that the central bank is not a politically compliant agency to provide cheap or easy credit to cover the government's fiscal deficit. These principles are best established as tenets of sound public administration, rather than simply as IMF conditions during the duration of the donor-assisted financial stabilization program.

Some post-conflict countries may wish to replace their old currency with a new one. This type of currency reform can be useful in a variety of ways. It can help restore confidence, show a break with the past, deal with simultaneous circulation of several versions of the national currency, or combat widespread counterfeiting. Issuing a new currency is an enormous logistical undertaking, which requires a number of important steps: 1) designing the currency (including security features); 2) determining currency denominations; 3) choosing a printer; 4) deciding on the quantity of the new currency to introduce; 5) announcing and publicizing the conversion plan; 6) deciding a date and mechanism for conversion; 7) distributing the new currency; 8) establishing terms for the old-to-new conversion, including determination of the conversion rate; and 9) disposing of the old notes taken from circulation. USAID was a major player in the introduction of new currencies in Afghanistan and Iraq and could be asked to play a similar role in other countries.

KEY TRADE-OFFS

Donors providing assistance to post-conflict countries must make decisions quickly, on the basis of specific trade-offs that are much more acute than in stable developing countries. In the area of monetary policy and institutional reforms, the key trade-offs faced by donors include *effectiveness vs. efficiency* and *short term vs. long term*.

Effective vs. efficient

Rather than resurrect and manage a national currency, a number of post-conflict states have adopted a strong foreign currency as their de facto legal tender. This approach, followed by East Timor (which used the dollar) and Kosovo (which used the DM/Euro), obviates the need for the central bank to manage the country's monetary base. It also automatically regulates price inflation. If the national currency is retained, allowing the exchange rate to float flexibly offers another low-tech approach to central bank exchange-rate policy.

Retaining a separate national currency gives the central bank some potential to manage real exchange rate (RER) developments by intervening in the exchange market. For this reason, it may be a valuable tool. Post-conflict countries, especially small ones where donor flows may constitute a large share of GDP, risk experiencing significant RER appreciation when they receive large amounts of foreign assistance.[4] A low or depreciated RER has a positive impact on export competitiveness and on employment in both the export and the import-competing sectors of the economy. In contrast, excessive appreciation of the RER (unless prevented by the central bank buying on the local market and accumulating foreign exchange) can severely hamper domestic producers' ability to enter export markets or compete with imports.

The central bank may need to provide temporary licenses to pre-existing commercial banks, even if there are doubts about the banks' longer term viability. Commercial banks provide the public and the government with critical payments services (e.g., for meeting employee payrolls). In many post-conflict countries, pre-existing private or state-owned commercial banks have a network of branches and facilities that may be able to provide these services. (See also Chapter IX: Banking and Finance.) In such a situation, it may be best for the central bank to provide temporary licenses to these existing institutions, even if there are doubts about their longer term viability. Later—as stronger competitors enter the banking sector, as credit skills become more important to bank viability, and as bank supervision skills improve—a shake-out may be needed to liquidate weak institutions or force mergers. In 2005, for example, Kosovo's Central Banking Authority determined that just such a shake-out was needed.

Short term vs. long term

In some cases, a central bank and a commercial banking system must be created from scratch. This is necessary when neither a viable central bank nor commercial banking system exist. (See Lonnborg 2002.) In Kosovo and East Timor, for example, the IMF led the establishment of a Central Payments Office (CPO), managed by expatriate experts, which provided transactional banking services between the private sector and the government and monitored government finances. In both cases, the CPO evolved quickly into a banking and payments authority with a stronger local legal foundation and with wider central banking responsibilities, including the licensing and supervision of commercial banks.

[4] For example, Elbadawi et al. (2007) found that Nicaragua, El Salvador and to a lesser extent Mozambique were post-conflict countries that experienced high ODA and appreciating RERs.

Even where the central bank and a commercial banking system do not have to be created from scratch, it is important to gauge how well they are performing their basic functions. Assistance may be needed to ensure reasonably sound management of monetary policy and sufficient transactional services so as not to constrain the economy's capacity.

In the longer term, the goal should be a transition into a full, two-tier banking system consisting of a viable central bank and the rudiments of a commercial banking system (including a number of participating banks, microfinance, and nonbank financial institutions).

Programming Options

In the early post-conflict period, the IMF usually leads an initial assessment of the country's monetary policy and institutions. The World Bank, USAID, and other donors also play important roles in this process, which identifies areas where organizational reforms are needed and establishes priorities for immediate donor assistance. The assessment addresses such questions as:

- What key steps should be taken in the monetary and banking area to facilitate both basic governmental functions, and humanitarian and rebuilding efforts by donors? (For example, should payroll disbursing facilities and revenue collection channels use existing or new bank branches?)
- Which relevant institutions and resources are intact? Does a viable central bank exist? If so, is it able to design and implement appropriate monetary policy? Which, if any, of the pre-conflict institutions and policies should be restored to re-establish a monetary authority?
- Do ministries and state enterprises maintain multiple, independent deposit accounts in local and overseas banks? (In Afghanistan, for example, various entities had $700 million in such accounts.) Are there any effective procedures for the Finance Ministry or central bank to monitor and control such accounts?
- Is the central bank able to effectively manage the country's monetary base through exchange-market or domestic interventions?

A plan of action must be developed to address the weaknesses identified by the assessment. The central bank (or the interim entities in place until a central bank can be re-established) has a number of key roles, including:

- monetary control
- foreign exchange market management
- collection of market data on prices and exchange rates
- banking supervision and regulation
- capacity-building for all of these key roles
- introduction of a new currency (in some cases)

Inflation control is the monetary authority's prime responsibility. Bringing inflation rates down to a low, stable level is of immediate concern. In post-conflict countries needing significant structural reforms and "relative-price" adjustments, however, it may be best to resolve some major economic and trade distortions (such as those created by highly inefficient gasoline subsidies in Iraq) rather than seek to bring down inflation rates too quickly.

An organized foreign exchange market for the national currency should be created, where applicable. In order to manage the exchange rate, the monetary authority needs a market where it can buy and sell currency. Decisions need to be made about who can deal in foreign exchange. Who can participate in the official foreign exchange auctions that are required when the government receives significant revenue in the form of foreign currency? What rules should apply to those auctions? Who is allowed to trade in foreign exchange more broadly?

The availability of good data, often ignored, is a key component of a sound monetary policy-making process. Statistical offices in post-conflict countries often have greatly reduced capacity and are unable to produce good inflation data. In such cases, interim measures for collecting consumer price data will need to be put in place. Technical assistance and training from USAID and other international donors may be needed to improve data quality for policy-making.

Building the monetary authority's institutional capacity is vital. Technical assistance in each core competency should be accompanied by training aimed at strengthening the monetary authority's operations. Initially, on-the-job training should focus on the operational work at hand. As the immediate post-conflict phase ends, donors should finance more formal training activities, including both in-country courses and regional workshops and seminars. A limited number of high-level officials should be sent to developed countries for training. In coordination with the IMF and other donors, USAID or the U.S. Treasury Department often play an important role in building critical capacities in the payments, supervisory, and money-market development and management functions.

AVAILABLE RAPID ASSESSMENT TOOLS

See Chapter IX: Banking and Finance.

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VI. EMPLOYMENT GENERATION

Overarching Objective: *generate increased job opportunities during the first several post-conflict years*

Donor-financed interventions are needed to provide employment until security improves and to deliver a broad-based stimulus to economic activity through increased incomes for labor.

POLITICAL AND SOCIAL ISSUES

Population displacement during a conflict can impede workers from returning to their traditional employment. During a conflict, many workers move into towns, which serve as safe havens, or into refugee camps. These internally displaced persons (IDPs) often have found economically viable ways to adapt to their new locations; they may have limited incentives to return to their pre-conflict occupations. Populations in refugee camps may also face difficulties in returning to areas where infrastructure has been destroyed or become unusable through years of neglect. Even with resettlement packages serving as inducements to go back, people may be dissuaded from returning by a perception—often accurate—of insecurity and by a lack of access to schools and health care at home.

In many post-conflict countries, donors and host governments face pressure to generate employment opportunities, which are seen as necessary for establishing and maintaining social tranquility. Two challenges are typically faced by donors:

- The country's program for disarmament, demobilization, reintegration, and repatriation (DDRR) may require targeted efforts to provide ex-combatants with jobs, at least in the short term. A key aim of these efforts is to keep potential "spoilers of the peace" off the streets and help wean them away from warfare and banditry, which remain feasible alternative occupational tracks. To ensure widespread benefits, the DDRR program should also include community participation.
- During the post-conflict period, the security situation and the commercial legal environment can present very high risks to private investors and enterprises. Because of these risks, there may be a pronounced lag in the rebound of private enterprise and employment, until security improves.

In response to these pressures, donors frequently have sponsored mass employment programs, which provide transitional employment to the targeted local labor force and deliver vocational or remedial training and skills development. Donor-financed employment-generating activities can be implemented through grants to private enterprises, NGOs, community groups, local governments, or other public-sector entities. Using a wide variety of organizations for this purpose can help overcome a general lack of management capacity among all such organizations.

KEY TRADE-OFFS

Donors providing assistance to post-conflict countries must make decisions quickly, on the basis of specific trade-offs that are much more acute than in stable developing countries. In the area of employment generation, the key trade-offs faced by donors include *effectiveness vs. efficiency*, *urgency vs. legitimacy*, and *short term vs. long term.*

Effective vs. efficient

The primary purpose of post-conflict transitional employment is to provide work opportunities, not to develop new enterprises or provide sustainable, long-term jobs. In stable, developing countries, employment generation programs focus on sustainable employment and on training for jobs known to be in demand, primarily relying on private employers and private training providers. Policy attention focuses on reducing legal and administrative barriers to labor mobility as a means of increasing the labor market's efficiency.

In post-conflict settings, however, given the urgency of responding to the pressures described above, the sustainability of jobs becomes a secondary concern. Many of the jobs offered through transitional employment programs are not likely to lead to future employment; they may only provide on-the-job training and income for a short period. Nonetheless, this may be sufficient if opportunities for other types of jobs begin to appear as the economy revives.

Urgent vs. legitimate

The challenge for donors is to conduct transitional employment programs in a participatory fashion and still get them up and running quickly. The programs must produce visible benefits quickly, often before the host government has adequate capacity to oversee them. This leads to the risk that donor-financed employment programs—managed by international NGOs—may be seen as undermining, rather than reinforcing, the new government's legitimacy. This risk, however, needs to be weighed against the risk that newly demobilized combatants (and others) will engage in destabilizing behaviors if there are no opportunities to contribute positively to society.

Short term vs. long term

Donors need to make clear that funding for transitional employment programs is time-limited and will not continue indefinitely. These programs are intended to be short-term stimuli and must be understood as such by participating communities. As revival of the economy proceeds, donor-financed transitional employment-generation programs will be phased out in favor of programs to improve labor market efficiency and promote sustainable private-sector employment.

PROGRAMMING OPTIONS

Donors and host governments must try a number of different approaches to encourage workers to return to the livelihoods that offer the quickest route to productive, private-sector employment. Because of the challenges involved in returning workers and families to their farms and villages, both "push" and "pull" approaches need to be used. Early in the post-conflict period, a steady phase-down and closure of refugee camps is an important tactic for "pushing" workers back to sustainable private employment. To help "pull" workers toward useful and eventually long-term jobs, approaches commonly used in post-conflict settings include:

- cash-for-work programs
- transitional assistance to farmers and micro-entrepreneurs
- vocational training programs

Donors usually rely on NGOs or contractors to design and implement employment-generation programs.[1] This approach is used because the central government and line ministries typically have little capacity to select program priorities, and even less capacity to implement mass-employment, mass-retraining, and safety-net programs effectively and without corruption. Donor contractors or NGOs establish partnerships, direct programs, or sub grant programs, often at the community level, to carry out appropriate employment-creating activities.

Cash-for-work programs

The purpose of mass-employment programs is to provide flat, low-wage job opportunities that will be selected only by workers whose alternatives are very unproductive or unprofitable, or by workers from the most vulnerable populations. This approach minimizes the risk of interfering with the revival of traditional production (e.g., drawing away field workers needed for seasonal farm planting or harvesting activities). Wages generally are paid in cash rather than in food rations alone, but wages may be supplemented by food served at the worksite. This creates an incentive for workers to show up every day and generates opportunities for local "caterers" to enter the market economy.

Local community leaders almost always are involved in identifying targets for rehabilitation, both to meet specific needs and to promote local ownership. Donors should establish clear overarching guidelines for selecting targets for work activities, drawing on common, area-wide priorities that are conducive to labor-intensive, low-skill work methods. Responding to local priorities can result in a quite diverse set of activities, as it did in Liberia in

Box VI.1 Cash for Work Program: Liberia's Community Infrastructure Program (LCIP)

The June 2005 workplan for the LCIP called for employment-generating programs in seven counties, covering six major areas:

- road and bridge rehabilitations
- school renovations
- agriculture and agribusiness
- administrative building renovations
- health center rehabilitations
- environmental sanitation/drainage

LCIP activities during the first quarter of 2006 were very diverse. They included:

1. the start of construction on facilities for six rice mills and two cassava-processing mills in Lofa, Nimba, Gbapolu, and Capemount counties;
2. completion of the Bong Road;
3. continued rehabilitation of other, smaller feeder roads in Bong and Grand Gedeh counties;
4. installation of palm oil processing equipment in Foya, Lofa;
5. completion of the Gbarma–Wesua road project in Gbapolu, with eight major log bridges and two minor bridges constructed;
6. the start of construction on the Zleh town dam project, which will support 250 acres of swamp rice projects in Grand Gedeh County;
7. continuation of the RAP program in Bong and Nimba counties;
8. continuation of the Monrovia Apprenticeship Program, with 447 apprentices working in 59 businesses;
9. completion of rehabilitation and inauguration of AMEU Hatcher Hall; and
10. identification and commencement of 18 community-development projects in the 33 Monrovia communities: a market building, 15 road/bridge rehabilitation projects, 19 latrines, a community drainage clearing project, and a footbridge. Three schools were rehabilitated and officially opened.

[1] USAID's efforts in this area are usually led by the Bureau for Democracy, Conflict and Humanitarian Assistance, Office of Transition Initiatives (DCHA/OTI).

2005 – 2006. (See Box VI.1 on the previous page.) Infrastructure rehabilitation, when it can employ sufficient numbers, generally is preferable to vocational training.

A timely way to reach unemployed workers is to fund local private-sector subcontractors or NGOs to carry out activities.[2] Although the alternative—funding through local governments—might have the advantage of helping these governments become operational, their disbursement process tends to be slow and to discourage the use of labor-intensive methods. Disbursement delays may result in wage-payment delays, which can lead workers to strike and protest.

Community-based approaches to employment generation can help reduce conflict between ex-combatants and civilian workers. Because providing employment benefits to former combatants has intuitive appeal to peace-keeping forces (e.g., the UN military force), donor efforts may be skewed in that direction. This practice, however, can aggravate hostility and resentment by war-affected civilian returnees. It is important to integrate civilian workers and ex-combatants, but doing so is not a guarantee against hostilities. In Liberia, for example, both ex-combatants and war-affected returnees were targeted for assistance, but antagonism between the groups tended to boil over into direct personal conflict at the worksite. To avert these clashes, project officials chose not to segregate the groups but rather to incorporate one or two counselors as full-time behavior-management mediators within each work group. Avoiding such problems is a strong argument for community-based approaches, which include community members as beneficiaries and include traditional local leaders in the design of programs to help mitigate conflicts.

Assistance to farmers and micro-entrepreneurs

Direct assistance to farmers often accelerates both the recovery of agricultural production and the repatriation of the population to farms and rural areas. Farmers are the most commonly found entrepreneurs in low-income post-conflict countries. For this reason, "re-tooling" them with basic implements and seeds is a widely practiced intervention in many post-conflict settings, especially when the rural and farming population has been displaced. Intervention is generally carried out through grants. In the Philippines in the late 1990s, for example, USAID introduced a farming support program for ex-combatants, to help fulfill promises in a peace agreement. (See Box VI.2 below).

BOX VI.2 USAID'S GEM-ELAP PROJECT IN MINDANAO

USAID introduced the GEM-ELAP project in Mindanao, to help fulfill promises in the September 1996 peace agreement between the GOP and MNLF. From 1997 to 2000, the project (which targeted ex-combatants) assisted participants with the startup or resumption of farming activities (principally high-yield corn for local markets and seaweed harvesting for export). An evaluation and independent survey conducted at the end of 2000 found that most participants had benefited substantially from the program. Average yields improved by about one-third for corn and by about half for seaweed harvesting, which became much more prevalent in the target area. Input subsidies ended after two cropping cycles, but 90 percent of the corn and rice farmers who continued production were using a similar set of seeds and fertilizers.

Meanwhile, as indicated by the evaluators, the program's pacification goal also was largely achieved. Livelihood from ELAP farming had become a better alternative for many former combatants. In Ramain and Maguing in Lanao Province, the incidence of banditry, burglary, and other illegal activities was reportedly reduced to almost nil; local authorities attributed this to widespread ELAP participation in those areas.[3]

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[2] For example, for rehabilitation and upgrading of rural roads in Liberia during 2004-2005, private local contractors initially bid for the contracted road segment using their preferred efficient means of construction; then an additional payment was negotiated for the contractor's commitment to hiring and paying (at low, flat wages) an additional block of local workers to assist with construction.

[3] USAID and Mindanao State University–General Santos City Foundation, Inc., "ELAP Assessment Survey Report" (2001), p. 18.

Apart from farming, USAID generally does not recommend assistance programs that primarily help ex-combatants and rural workers start their own businesses. The reason is that most ex-combatants and unskilled civilian laborers are unlikely to have the business skills needed to become successful micro-entrepreneurs. The high failure rates typical of business start-ups are likely to be even higher for this group. If the start-ups involve loan finance, many of these workers may find that repaying a micro-loan is a personal hardship rather than a means to a better future.

Vocational training programs

Vocational training is a popular donor approach in post-conflict situations, even though its impact has not been well-measured and the evidence of its success is mixed. Worker training programs have often been viewed as a way to absorb the unemployed and make them employable. Classroom vocational training, using local instructors with relevant skills (such as sewing or carpentry) has the greatest potential to reach large numbers of participants. This approach, however, may not subsequently lead to sustainable employment.

Enterprise-based apprenticeship training has proven to have a greater impact on sustainable employment than training in state-run institutions. Apprenticeship training is facilitated by providing financial incentives to enterprises that accept workers as apprentices or trainees, pay them an emolument, and hire them as full-time employees. Additional employer incentives may also be needed to break bottlenecks to the expansion of their enterprises.[4]

> ***BOX VI.3 REBUILDING LIVELIHOODS: MOZAMBIQUE AND BURUNDI***
>
> Following national elections in Mozambique in November 1994, USAID sought to develop an employment-generation program that would reach as many ex-combatants as possible. The chosen approach involved providing grants to a variety of groups, including churches, community groups, and private employers. Grants funded by USAID and other program donors resulted in short- and long-term employment for 12,000 ex-combatants. To avoid identifying ex-combatants as deserving special treatment, grant recipients employed a mix of ex-combatants and civilians in their activities. While many of the jobs were temporary, a number of grants did result in longer-term employment.
>
> In Burundi, USAID focused on vocational skills training to promote successful community reintegration and to address both land pressure and a lack of economic opportunity. USAID's program trained students in six marketable vocations and offered grants to student-formed associations. The training emphasized off-farm income-generating opportunities, which helped alleviate land pressure and reduce poverty. In addition to literacy and math education, students also received communications and conflict-resolution training. Program recipients included undereducated youth, returning refugees, IDPs, ex-combatants, and members of other vulnerable groups. Program participation by undereducated youth and ex-combatants successfully reduced violent incidents perpetrated by these groups; both the students and their neighbors stated that the students were less violent and more productive citizens as a result of the communications and conflict-mitigation training.

A 1997 ILO report summarized post-conflict reintegration results in Mozambique, drawing on a number of sources.[5] With 12,000 beneficiaries, the program (funded by USAID and other donors) reached a significant number of ex-combatants, although this number remained a small proportion of the estimated 90,000 to 150,000 demobilized soldiers. (See Box VI.3 above.)

AVAILABLE RAPID ASSESSMENT TOOLS

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[4] For example, in the second and third years of the LCIP employment program in Liberia, urban and rural apprenticeship programs were initiated and expanded. These programs offered incentives to master craftsmen—in such areas as carpentry, metal-craft, fishing, and masonry—by providing a project-funded structure (10-year lease) and, for the first eight months, locally prepared lunches for both employees and the master craftsmen. The program also initially funded apprentice wage payments to employees; wage costs are now fully borne by employers.

[5] Stuart Maslen, *The reintegration of war-affected youth: The Experience of Mozambique (* ILO, 1997). "…the Commission for Reintegration (CORE) Assembly Areas for demobilization were opened in late 1993 and the first soldiers arrived in early 1994. The demobilization process took anywhere from six weeks to four months,…According to one report in February 1996, CORE provided 12,000 ex-combatants with vocational kits, employment promotion, and vocational training activities, through programmes implemented by the International Organization for Migration (IOM), UNDP, ILO and the German cooperation organization, Gesellschaft für Technische Zusammenarbeit (GTZ). …As a result of its reintegration projects, GTZ claimed to have already created 6,200 jobs on paper for demobilized soldiers in four provinces, of which 5,000 former soldiers were actually employed. The head of the GTZ reintegration programme in Mozambique believed that a substantial percentage of the jobs would be sustainable."

The best available guidance for post-conflict transitional employment programming is the 2007 USAID publication, "Community-Based Development in Conflict-Affected Areas." This document provides many examples—including those described in Box VI.3 above—and discusses programming issues in detail.

REFERENCES FOR RELEVANT CASE STUDIES

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VII. PRIVATE-SECTOR DEVELOPMENT

Enterprise is the key to sustainable growth. Insecure, risky environments—where there is considerable uncertainty about the future—cause businesses, both formal and informal, to shorten their time horizons and engage in activities that they believe are lower-risk and offer a higher return. In post-conflict countries, the challenge is to convince businesses to take a longer-term view and accept somewhat more risk.

After security and macroeconomic policies, the business enabling environment is the most important element for encouraging and sustaining growth. During the immediate post-conflict period, it is absolutely critical to generate jobs and get businesses back on their feet with donor financing. Such financing, however, cannot and should not persist indefinitely. As soon as possible, the host country should introduce reforms to encourage private enterprise and to make clear its commitment to maintaining a business-friendly environment. The following two sections of the guide provide recommendations on: A) how to create an environment that enables private-sector growth, and B) how to strengthen enterprises so they can compete in the emerging post-conflict economy.

A. PRIVATE-SECTOR ENABLING ENVIRONMENT

> ***Overarching Objective:*** *reduce risk and increase the predictability of the environment in which business is conducted*
>
> *Without timely improvements in both factors, businesses—of any size—are less likely to initiate or increase business activity. They may even withdraw existing investments. The first step for encouraging increased private-sector activity is to lower the risks.*

Political and Social Issues

The risks confronting business in post-conflict societies tend to take two primary forms: 1) uncertainty over the "rules of the game" (laws and regulations), and 2) an inability to enforce rules that are certain (weak institutions). Conflict can wreak havoc with both the rules of the game and their enforcement, and thus with private-sector activity. Conflict often leads to a breakdown in the government's ability to enforce the laws and regulations that govern economic activity. Courts may have ceased to function effectively, making it difficult—if not impossible—to enforce contracts. Increased corruption can lead to disparate and unpredictable enforcement of business and trade regulations, enabling some businesses to evade taxes, licensing restrictions, or customs duties that others must pay. Frequently, the rules themselves may be in

After security and macroeconomic policies, the business enabling environment is the most important element for encouraging and sustaining growth.

flux, with unexpected decrees or fluctuating enforcement policies, making it difficult to pursue a rational business plan.

To reduce risks and encourage private-sector activity, donor-supported enabling environment programs must be pragmatic and effective. In post-conflict economies, investment is needed more than ever to spur growth, jobs, and stability. Practical considerations may call for donor assistance approaches that would not be preferred in a more stable environment. Reformers may need to employ rapid policy interventions, without sufficient stakeholder input, or may need to encourage informal enterprises in the short-term, shifting to formalization projects only after stabilization.

The devastation wrought by conflict can offer important opportunities* not *to rebuild. While certain essential government services—such as security and sanitation—need to be restored rapidly, many countries that fall into conflict are characterized by burdensome over-regulation of business. Government offices may have attempted to control or seek rents from economic actors, rather than facilitate economic growth. These practices increase both the cost and the risk of doing business, while undermining respect for government. Programs should be careful to rebuild only those services that enhance economic growth, and should assist government agencies in shifting from a control paradigm to a facilitative model.

Post-conflict reforms offer an opportunity to introduce a legal and regulatory system that applies equally to all economic actors. The pre-conflict legal system may have favored and protected vested interests through a variety of restrictions on competition or through incentives for noncompetition that favored entrenched groups. This may apply particularly to women, who typically may have been increasingly marginalized during the conflict or who may simply have not had access to significant economic opportunities in the past. Conflict can upset the dynamics that gave rise to such arrangements, enabling post-conflict reforms to establish a system that provides opportunities without discrimination.

Key Trade-Offs

Post-conflict governments sometimes champion market-oriented reforms, at least during the initial recovery phase. Donors (and particularly USAID, with its strong focus on private-sector, market-oriented development) should wholeheartedly support such enthusiasm for reform. The imperative of short-term progress may call for less-than-perfect solutions with less-than-ideal partners. This approach can reduce impediments to doing business while long-term efforts are underway to improve legal and regulatory systems and build the capacity of regulatory and enforcement institutions. Pragmatic short-term measures send an important signal to private-sector actors that enterprise is strongly encouraged and that the government intends to protect the interests of investors. The inevitable trade-offs include *effectiveness vs. efficiency*, *urgency vs. legitimacy*, and *short term vs. long term.*

Effective vs. efficient

Effective, immediate solutions are not always efficient, but may be important in some situations. Power generation offers a prime example. Post-conflict Liberia lacked capacity to provide power from the national grid, but private suppliers of electricity (from privately owned generators) have served homes and small enterprises without legal sanction. Although less efficient and more expensive, such unregulated electricity generation was a very effective solution to the immediate problem of scarce electrical power. Reliance on informal-sector providers should be strongly encouraged and even legally recognized until local or national power supply capacity can be restored. At that point, larger producers offering lower costs can recapture customers from the less efficient producers. This pragmatic approach serves business by reducing the risk of inconstant electricity supply. It also creates a more business-friendly environment by permitting small-scale manufacturing and services to continue operating.

Urgent vs. legitimate

The urgent needs of a post-conflict economy sometimes dictate short-cuts to the policy process in order to encourage immediate economic activity. Reforms to the business enabling environment often require policy changes that must be enacted through legislation or regulation. Normally, effective legal and regulatory reforms require several years of interaction among stakeholders to ensure sufficient consensus for implementation. In a post-conflict environment, however, the normal vetting of reforms with stakeholders may not be pragmatic.

Urgency does not mandate illegitimacy. Sacrificing legitimacy for the sake of urgency makes the enabling environment less stable—and thus less attractive—to investors who may have been left out of the policy reform process. New laws that suddenly appear without input or warning can negatively affect the calculus of investment and drive investors away.

Reforms must be vetted—at least briefly—with the affected stakeholders to ensure sufficient buy-in to support implementation. In Bosnia, for example, successful pledge registry reform engaged the banking sector extensively; in contrast, the failed leasing law was championed by foreign experts without meaningful participation from the local financial community.

In another case, shortly after an interim government took office in one Islamic country, a banking law was drafted by foreign experts and passed in a very short time frame, in English (not an official language). Although the draft law was not widely vetted, it had been cleared with committed local and expatriate banking investors, who invested heavily in the banking sector once the law was passed. Similarly, another group of foreign drafters prepared a framework commercial law. It had minimal local vetting and was passed on an emergency basis without additional input. The commercial law has subsequently been heavily criticized by the local business community, as well as by local and foreign legal specialists. It does not appear to have led to any investment thus far. The basic difference between the two laws was legitimacy. The banking law responded to recognized demand and was substantively accepted by a target group of stakeholders who were sufficiently, although hastily, involved in the process. It permitted banks to meet identified demand for financial services. It also was approved by local experts as compliant with Islam, and it was translated shortly after enactment. The commercial law, by contrast, had not yet been demanded by anyone other than foreign experts. It had no local buy-in and was not submitted for effective analysis by Islamic experts. Both were perceived to be urgent; only one was also legitimate.

Short term vs. long term

As a corollary to the problem of urgency, reformers must be careful to prioritize short-term versus long-term programmatic needs. Post-conflict business environments require extensive reforms, but do not require all of them immediately. In fact, local absorptive capacity is usually very limited. Often, many of the most qualified government officials and business people have fled the country during the conflict, leaving key institutions with only a thin layer of technical capacity. Attempting too much too soon can overwhelm reform efforts, with the result that few needed reforms are processed.

Reforms that respond to the business community's actual, immediate demands should be addressed first, with longer systemic changes implemented later. For example:

- *Court reform:* It takes five to ten years for judicial programs to achieve results, even in stable countries. In Bosnia, it took ten years of project support to redesign and stabilize the court system enough to be able to delve into serious issues of delay and corruption. Although such projects should be started as soon as feasible, attention should primarily be given to shorter-term solutions, such as alternative dispute resolution, private enforcement (repossession), and the use of existing customary courts.

- *Competition:* Post-conflict countries need to focus on pragmatic, short-term actions to reduce obstacles to competition. These include reducing the costs and time required to register a business, removing or simplifying licensing requirements, removing export or import restrictions to allow more players in the market, and reducing the burden of regulations wherever possible. The immediate post-conflict period often permits countries to make many such changes before the previously strong vested interests re-establish past privileges and protections. At a later stage, countries may engage in the longer-term process of formal competition reform to solidify and build upon their short-term reforms to encourage competition.

- *Process re-engineering:* Serbia's commercial and civil codes under Milosevic were said to create a "debtor's paradise" in which lenders could not enforce debts. The codes needed extensive reforms over the long term, but in the short term it was possible to introduce "mini reforms," such as creating a pledge registry system for movable property, which had not existed previously. In Croatia and Bosnia, many of the delays in court systems were caused by practical problems that could be addressed without legal amendment while reformers addressed systemic problems that require years of work.

Programming Options

Donors should seek to restore the business community's confidence to reasonable levels in the short term, while commencing work on the systemic changes needed to support long-term growth and stability. This requires concrete reductions in risk as perceived by business owners and managers. The following guidelines can increase the impact of donor assistance programs aimed at the business enabling environment.

- *Respond to demand:* The business community usually knows the constraints in the business environment and should play a central role in prioritizing the reform agenda. Donors need to be careful, however, to make sure that they connect with the broader business community, not just the elite or those who speak English. In Afghanistan, business associations surveyed the country's businesses and identified domestic priorities, including electricity, access to land, and reduced regulation. Where projects were connected to these needs, there was substantial support. Other "urgent" projects being pursued by donors, which were not on the list, lacked local support and legitimacy.

- *Remove constraints:* Reforms can take three basic forms: permitting previously prohibited behaviors; prohibiting previously permitted behaviors; and introducing new behaviors. In post-conflict settings, the most effective short-term reforms are likely to involve permitting business activities that previously had been constrained, including economic opportunities for women. Steps such as removing excessive licensing requirements, eliminating export restrictions, or removing gender discrimination in hiring can legitimize and expand economic activity, having an immediate impact. Governments are unlikely to have the capacity to enforce new restrictions or define complex new opportunities until the socio-political environment stabilizes.

- *Expand opportunities:* Urgent pressures may provide a chance to expand some concepts of legitimacy, such as women's rights. Just as the World War II economy drew American women into factories and hastened changes in women's employment rights in the U.S., the need for labor in post-conflict economies may open doors for women to move beyond traditional roles. In some cases, such as Afghanistan—where educated women were shunted into obscurity under the Taliban—a transforming economic environment is ripe for expanding opportunities for women professionals and workers.

- *Reduce regulation:* Regulation is the seedbed of corruption. Although regulation is necessary for many purposes, extensive and complex regulations create greater opportunities for rent-seeking. Reforms aimed at reducing and removing constraints by eliminating and simplifying regulations will increase economic activity while reducing bribery and the risks inherent in corrupt systems.

- *Scale down:* Small changes can often produce large impacts. Reformers should look for changes that can be accomplished with the “stroke of a minister’s pen” while commencing the slow, time-consuming legal and regulatory processes that may take years. In Guinea-Bissau, eliminating warehouse ownership requirements for the export of cashews introduced extensive competition with concomitant increased investment. This was a much more efficient and effective outcome than would have been achieved through long-term programs to reform competition law.

- *Plan for amendments:* Some legislation will need to be prepared quickly and will inevitably need to be corrected based on lessons learned during implementation. Many countries provide for interim or temporary regulations, often by executive decree, which expire unless adopted by a certain date. By using interim measures, or by building in a period of review and revision, policy-makers can reassure businesses that they will have an opportunity to correct hastily drafted measures.

- *Announce changes:* An often-cited barrier to investment in unstable societies is that changes take place by surprise. New rules appear or old ones disappear without warning, shaking investor confidence and undermining investment assumptions. To ensure greater positive impact, projects should invest extensively in public education and communication. This also helps re-establish trust in the government, leading to greater stability.

- *Go beyond the capital:* Reform efforts that neglect to engage stakeholders outside the capital city may reinforce pre-existing social conflicts while failing to build broad consensus for implementation. Urgency may limit the amount of time dedicated to consensus-building in the provinces, but should not eliminate such efforts altogether. It is important for businesses with national scope to know that new rules apply throughout the country, not just in the capital.

Extensive destruction during conflict means that there is an extremely wide range of possible interventions, which must be prioritized for impact and feasibility. Donors should conduct rapid, gender-sensitive assessments of business-sector needs and priorities to ensure that the demand for reforms influences the supply. These assessments can be repeated periodically and eventually can be run by local business organizations. Key indicators should also be established to direct the efforts of donors, the government, and the business community toward the most essential targets at the outset of recovery efforts.

While the guidelines listed above provide some orientation on *how* to implement reforms more effectively, they do not necessarily indicate *what* should be done. Based on the established needs of businesses, however, certain reform needs are relatively predictable. The programming opportunities outlined in Table VII.1 on the following page provide some examples of options that may produce high-impact, short-term results.

TABLE VII.1 PRIVATE-SECTOR ENABLING ENVIRONMENT PRIORITY AND SEQUENCING OF ASSISTANCE

Item	*Urgent*	*Immediate*	*Intermediate*	*Consolidating*
Reduced business regulation				
Improved physical infrastructure				
Court reform				
Alternative dispute resolution				
Land reform				
Policy prioritization and process *(w/ private sector)*				

High-intensity level of assistance	Lower-level intensity of assistance	No assistance during phase

- *Land:* Real property rights are fundamental to commercial activity. Indeed, property distribution frequently is a cause of conflict. Conflicts tend to reduce land security, either through the destruction of deeds and other title documents or because of wartime population migrations. Fortunately, governments sometimes have large tracts of land with undisputed title that can be privatized or leased on a long-term basis to spark investment. Even where title is disputed, it may be possible to extend the use of leases through interim measures which protect the business that is leasing the property from any underlying disputes about ownership. More comprehensive reforms will take time, but should begin immediately.

- *Enforcement:* Although comprehensive judicial reform takes years, there are short-term efforts that can have a positive impact on stabilizing the business climate in the near term. Initial improvements can be achieved by working with customary and traditional dispute-resolution organizations or by building the arbitration and mediation capacity of business associations. Caution should be taken not to improve judicial enforcement unless the judiciary is generally respected; otherwise, enforcement efforts will destabilize the environment by supporting corruption and incompetence, and exacerbating perceptions of injustice.

- *Public-private dialogue:* It is not enough for donors to understand business priorities; the government also must be part of the conversation and education process. Programs should deliberately create mechanisms to improve communication and cooperation between the government and private sector, including women's organizations and representatives. This will help rebuild trust. It also will ensure more effective, business-friendly reforms as government officials come to better understand and accept market needs.

- *Over-regulation:* All players' access to markets must be improved by removing unnecessary and burdensome regulations. Marketing boards, price-control boards, and various licensing and approval authorities can significantly hamper and distort economic activity. At the outset, policy-makers should not be concerned with formal versus informal business; the goal is to stimulate economic activity.

- *Flexible labor policies:* To stimulate employment, labor policies should be highly flexible in the immediate post-conflict period. Governments may wish to adopt temporary policies that permit lower-cost temporary contracts to be used or that reduce burdensome contribution requirements. They can deal with more comprehensive, politically sensitive labor reforms once the economy stabilizes. Donors should promote the employment of women for both part-time and full-time jobs. The post-conflict environment may facilitate this, if the male labor force has been reduced due to death, emigration, or work-related relocation (such as public works programs). Special attention should be given to laws that exclude women from pursuing the same employment opportunities as men.

- *Foreign investment:* Foreign investors are likely to be more skittish than local investors in a high-risk environment. Therefore, it is important to provide assurances against expropriation and repatriation restrictions, as well as other risks. Such assurances might be achieved by adopting a new foreign investment code (as in Afghanistan) or by documenting existing protections. It also may be useful to prioritize reforms that are most likely to attract foreign investment, such as mining and infrastructure investments.

AVAILABLE RAPID ASSESSMENT TOOLS

A number of tools are available to pinpoint priority reform needs. USAID has two with particular relevance for post-conflict settings.

- *BizCLIR:* USAID has developed a multidimensional assessment tool for the commercial and business regulatory environment. *BizCLIR* has two applications: 1) an assessment of framework laws and institutions (the commercial legal and institutional law [CLIR] assessment), or 2) a business regulatory assessment, based on the World Bank's *Doing Business* framework. The tool has been used effectively in post-conflict countries, including Afghanistan, Croatia, Kosovo, Nicaragua, and Serbia. It recently has been revised for greater gender sensitivity. See www.bizlawreform.com.

- *Country Analytics*: USAID provides missions with short-term analytical services through the *Country Analytics*. Normally, these reports are prepared as desk studies, but for post-conflict countries a field visit is also involved. Each country report assesses a broad set of indicators to help identify trends, constraints, and opportunities in such areas as the private-sector enabling environment and the pro-poor growth environment. Indicators are analyzed against corresponding data for comparable countries.

The World Bank offers other relevant, useful tools:

- The *"Mini-Diagnostic":* The Foreign Investment Advisory Service (FIAS) is well-known for its *Administrative Barriers Report* (ABR), which is a large, in-depth report that covers a range of regulatory issues. It takes months and a number of missions for a large team to prepare an ABR. FIAS has found that its regular ABR can be used in low-intensity conflict-affected countries or in countries that are experiencing conflict in parts but not the whole (e.g., Nepal). For use in countries intensely affected by conflict, the ABR was reworked so that a shorter Mini-Diagnostic (maximum 10 pages) can be prepared by a smaller team in seven to 10 days. The Mini-Diagnostic crystallizes the main issues, but requires intensive preparation (principally by setting up meetings with government officials and carrying out a wide purposive sample of businesses) by knowledgeable donor staff on the ground.

- The *Survey of Informality:* FIAS developed the *Survey of Informality* in 2006, in response to the challenge of large-scale informality in post-conflict countries. Rather than estimating the scope of the informal economy (i.e., how many firms or businesses are informal), the *Survey of Informality* investigates the main causes of informality from the perspective of businesses. This enables it to obtain a user's point of view about the most critical blocks to formalization. The *Survey of Informality* is based on research-supported observations that informality is a hindrance to growth. FIAS, however, accepts the somewhat unorthodox view (shared by this guide) that informality in the very short term is less important than enabling people to earn incomes, regardless of whether they are earned in the formal or informal segments of the economy. The *Survey of Informality* has been used in Sierra Leone, Liberia, and Rwanda.

- *Doing Business*: The World Bank's *Doing Business* report has already captured statistics for 175 countries. It is updated annually to catalogue the burden of regulation on business. These prepared annual indicators enable rapid assessments to be conducted, identifying problematic areas in business environments. Additional analysis then can be conducted to address underlying causes and reduce the constraints on business activity. *Doing Business* is a valuable tool that helps provides direction for reform.

- Subnational *Doing Business s*urveys: The *Doing Business* survey can be adapted for use at a subnational level to compare differences in business environments at the municipal level. This allows more tailored reform initiatives, while inspiring competition between cities to improve their ratings. Such extended assessments can be accessed directly from the World Bank, FIAS, and USAID. The surveys have been used in a number of non-conflict-affected countries (e.g., Egypt, Philippines outside Mindanao, and Mexico), and also have been introduced in <u>Colombia</u> (particularly in some FARC-affected departments). The subnational *Doing Business* survey has potential for use in low-intensity conflict or mixed conflict-affected countries.

- *Enterprise Surveys: Enterprise Surveys* are used by the World Bank in a wide range of countries to explore issues such as the degree of corruption faced by businesses, the functionality of courts, the level and degree of crime faced by businesses, the availability and reliability of infrastructure, and the use of technology and labor for innovation. *Enterprise Surveys* have been used in conflict-affected countries such as Cambodia, Bosnia, Lebanon, and the Democratic Republic of Congo.

Other indexes, such as the *Economic Freedom of the World Index* and the *Global Competitiveness Index* also provide a quick overview of problem areas. Like *Doing Business*, they highlight symptomatic problems that should be addressed only after further analysis.

REFERENCES FOR RELEVANT CASE STUDIES

World Bank. 2007. *Doing Business 2007: How To Reform.* World Bank.

B. ENTERPRISE DEVELOPMENT

> ***Overarching Objective:*** *get enterprises working again*
>
> *The keys to rekindling private-sector activity are the restoration and maintenance of physical security and confidence that improvements in the economic environment will be sustained.*

Donors' short-term objective for enterprise development should be to get all types of businesses—large and small, formal and informal—working again, and to do so as quickly as possible. In the medium to long term, donors should focus on building the capacity of local sources of technical assistance, training, and finance for businesses, and on establishing viable mechanisms for public–private-sector dialogue.

Political and Social Issues

An economy controlled by entrenched interests—based on race, ethnicity, religion, political affiliation, class, or a combination of these factors—may have been an important cause of the conflict. When working at the enterprise or sector level, donors must understand the political, social, and economic factors that led to the outbreak of violence. Powerful old interests, typically reinforced by a dense network of social relationships, may attempt to revive the former economic structure to recreate their privileged positions. Donors should try to broaden the economic base and assist all businesses, including those that were not part of the controlling interests prior to the conflict. To do otherwise may exacerbate underlying conflicts within the society, possibly leading to further outbreaks of violence in the future.

As argued by Nourse and others (2007), a fundamental challenge is that conflicts disrupt markets.[1] To make matters worse, significant relief activity in the form of donated commodities and services, while critical to meeting human needs, has the side effect of distorting private-sector markets. In addition, many relief programs ignore market forces and thus exacerbate the problem. Eliminating all distortions due to relief delivery is impossible, for several reasons:

- In a chaotic and pressured situation, there are practical difficulties in identifying legitimate businesses and entrepreneurs and in designing programs to utilize them effectively.
- The inherent objective of relief programs is to address the immediate needs of crisis-affected populations. This focus on the symptoms of a crisis, coupled with the need for expediency, creates an emergency mindset that often keeps the relief community from addressing the causes of the conflict and from identifying solutions, including support for private enterprises.
- Many relief agency staff do not understand the private sector. In many cases, their distrust of profiteers is reinforced by exploitative business practices.

[1] T. Nourse, T. Gerstle, A. Snelgrove, D. Rinck and M. McVay. *Market Development in Crisis-Affected Environments: Emerging Lessons for Achieving Pro-Poor Economic Reconstruction.* (Small Enterprise Education and Promotion Network, 2007).

- Donors' funding cycles often are short-term and inflexible. This fact, combined with the need to assist large numbers of people quickly, favors the direct delivery of goods or services over the indirect use of partner institutions and market channels, which often have been weakened by the crisis.

KEY TRADE-OFFS

Donors providing assistance to post-conflict countries must make decisions quickly, on the basis of specific trade-offs that are much more acute than in stable developing countries. In the area of enterprise development, the key trade-offs faced by donors include *effectiveness vs. efficiency* and *short term vs. long term*.

Effective vs. efficient

In a post-conflict setting, it may be helpful to target enterprise development interventions to specific companies or specific sectors where there are opportunities for rapid improvement and where doing so would blaze a trail for others. This approach, while not economically efficient, can be an effective way to help get the economy moving again. It may be more pragmatic in a post-conflict environment than the standard enterprise development approach, which attempts to promote development broadly in line with market forces and usually tries to avoid giving particular enterprises an advantage over their competitors.

Short term vs. long term

Donors can and should vigorously promote private-sector participation in relief efforts. In the rush to provide needed relief, donors often have created their own distribution systems and failed to take advantage of existing private-sector capacity. This tactic often distorts or destroys the very market opportunities they will promote at a later stage. Instead, donors should rely on the private sector to deliver food, shelter, and clothing. Such "market-integrated relief" strengthens private enterprises and facilitates a swift transition from relief dependence to market-driven development.

The conditions required to engage in market-integrated relief are fewer than one might expect. Is there some evidence of existing market activity? Is there a reasonable level of security? Is the population relatively stable? Even under difficult conditions, relief and market development may be simultaneously pursued quite successfully without waiting for improvements in other factors that inhibit market activity.

Donors must seek a balance between the need to meet short-term relief objectives and the need to focus on longer-term private enterprise development. Finding a successful balance is challenging, precisely because of the tendency of relief activity to distort private-sector markets. It is, however, vital. The right approach will help society address longer-term economic and social issues in ways that can help prevent conflict from breaking out again years later.

PROGRAMMING OPTIONS

Private enterprises—both formal and informal—can and should play a major role in the rebuilding process. By encouraging local private businesses to participate in early relief activities, donors can simultaneously support the broader reconstruction process and begin to rebuild the country's private sector.

Enterprises face a host of challenges in the first few years after a conflict. Markets struggle to function effectively and uncertainty about the future discourages investment. Individual enterprises and entire sectors are likely to have lost capacity during the conflict, just as government institutions have. Consequently, they may not be as responsive to new business opportunities as they would have been prior to the conflict. Local businesses may also be excluded from participating in humanitarian assistance and relief activities. Market price and quantity information, which enterprises need to make economic decisions, may be scarce because of damage to the transportation and communications infrastructure.

To rekindle private-sector activity, action is needed on many fronts. Essential tasks include improving access to economic information, helping restore market functions, restoring macroeconomic stability, generating transitional employment, and increasing economic activity through donor spending. All of these steps will encourage entrepreneurship and enterprise development, especially if measures to improve the enabling environment are also taken. Box VII.1 below describes a successful market-integrated relief program that targeted both demand and supply.

To get enterprises moving more quickly, the circumstances of a post-conflict economy often justify going beyond the standard enabling environment prescriptions of removing impediments to the conduct of business, restoring market functions, and providing a secure, economically stable environment. Donors may need to support specific sectors or subsectors, or provide firm-level assistance.

Sector or subsector interventions often are used in post-conflict situations because their direct impact can be clearly measured. In developed economies, business support programs rarely focus on particular sectors or subsectors. The impact of broad or economy-wide interventions is difficult to measure, however. In post-conflict environments—where management resources are limited and it is politically important to demonstrate measurable impact—the sector approach can be helpful.

BOX VII.1 MARKET-INTEGRATED RELIEF: THE MOZAMBIQUE FLOOD RECOVERY PROGRAM

In Mozambique in 2001, a USAID-funded post-flood recovery program dealt directly with both the lack of demand from impoverished households and the lack of supply from businesses decimated by the flooding. USAID replaced lost household purchasing power by giving cash grants to affected households (vouchers could be used in other situations), creating immediate demand for market-supplied goods and services. Simultaneously, a program was established to increase access to credit for merchants and businesses in the crisis-affected areas. This enabled the businesses to finance new inventories to meet the demand created by the cash grants. Although applied in a disaster-recovery setting, a similar market-integrated relief approach could also be helpful in a post-conflict environment.

In Serbia, for example, following the NATO bombing in the late 1990s, a USAID project worked with five key sectors to promote enterprise growth and exports. The project helped increase export revenues in these five sectors by $350 million, with nearly $50 million attributable to project interventions. Now, a new USAID project is supporting the agricultural sector, with the goals of increasing agricultural exports and providing high-quality local products to replace imports from Western Europe.

By providing firm-level assistance, donors can both promote self-sustaining enterprise growth (of the assisted companies) and provide a practical example to encourage other local entrepreneurs. Although firm-level assistance by donors is often criticized as being too expensive, it can be justified in the immediate post-conflict environment as a means of getting enterprises moving again. In selecting sectors and firms for direct assistance, donors should focus on lines of business likely to have wide direct and indirect impacts. This necessarily implies “picking winners.” It makes no sense to support enterprises with poor chances for success when a key goal is to provide a demonstration of how to succeed through improved business practices and marketing. During later phases of post-conflict programs, donors should move away from providing direct firm-level support, and instead should help develop the financial system to provide long-term enterprise finance solutions.

The development of public–private-sector dialogue is critical. It is important both in the immediate post-conflict period and in longer-term efforts to promote economic growth. One effective approach, used frequently by USAID, is to work with business associations and, in a more limited number of cases, economic clusters, to develop mechanisms for promoting public-private dialogue. These partnerships serve a number of purposes: 1) they help establish a private-sector constituency for policy reforms, which will continue long after donor support has ended; 2) they can work with donors to build local capacity for training, advocacy, and other business development services; and 3) they can offer an effective channel for providing direct assistance to certain enterprises or types of enterprises. Box VII.2 to the right describes an example of successful partnership, this one between USAID and a business association in Afghanistan.

Box VII. 2 Women's Business Development in Afghanistan

USAID has supported a broad-gauged women's development program being carried out through the Afghan Women's Business Federation (AWBF). Established in October 2005, the AWBF is now a consortium of 10 women's business associations, covering such specialized activities as agriculture, beekeeping, carpet-making, and handicrafts.

The AWBF is actively training women entrepreneurs. In less than two years, 27 trainings programs have been carried out on a wide variety of topics, including organization, strategic planning, program development, project management, business plan development, entrepreneurship training, and design. To date, 459 women (and 165 men) have been trained in Kabul and six regional cities.

In addition to training, the AWBF provides policy information and advice to the government and the public about women's business activities. The organization is expanding women's association activities into the provinces. It is also awarding grants, inaugurating and supporting a women's design center and a women's trade development center, and initiating joint ventures with several women's businesses.

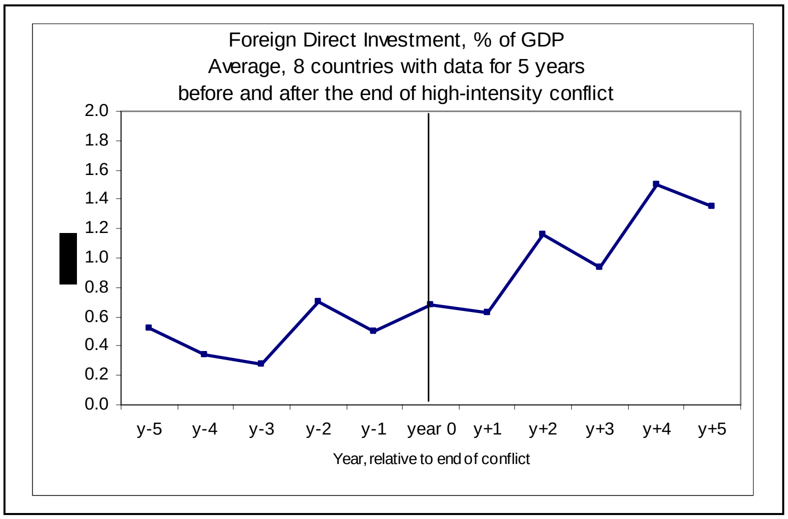
Foreign direct investment (FDI) generally is not an effective instrument for stimulating economic growth in the first few years after a conflict. In the short term, it is usually counterproductive to devote significant resources to attracting foreign investors, who are unlikely to enter the market before investment conditions justify it. As former Secretary of State Colin Powell eloquently stated it, “Capital is a coward.” Foreign investors in mining and other natural resource sectors, however, tend to be less risk-averse. They may enter the market sooner than corporations in other sectors, particularly if they have existing concessions or operations (which may have been dormant or scaled-down during the conflict). The employment impact of these investments, however, is often small.

Figure VII.1 on the following page shows the ratio of FDI to GDP in eight countries for which there is at least five years of before-and-after data. This ratio has tended to rise following the end of intense conflict. In general, however, the rate of direct investment in countries recovering from conflict has been low in absolute terms. FDI inflows varied widely by country and were marked by large year-to-year jumps within each country.

As security is restored and the risks of a return to conflict diminish, foreign direct investment may resume. Whether FDI becomes a major part of the post-conflict program depends heavily on the quality of the business climate and on investors' perceptions of country-specific opportunities and risks. Local and regional investors, as well as investors from the country's diaspora community, usually are better at assessing risks in a post-conflict setting, and also may be more tolerant of risk, than foreign corporations. Although it may be possible to combine local capital with international investors' talents or products, donors should not count on large investments from developed country corporations until the country can compete with other investment options.

In the medium to long term, donors should seek to build the capacity of local sources of technical assistance, training, and finance for enterprise development. By developing local business service providers who operate on a commercial basis, services will be less dependent on donor or government subsidies. Local governments with the financial resources to subsidize those services may ultimately choose to do so. Countries emerging from conflict, however, rarely devote their scarce budgetary resources to subsidizing business services. In any case, business services should be privately provided as much as possible, since experience has shown that private-sector services tend to be higher quality and more responsive to market conditions than those provided by governments. In the interim, there may be appropriate—even enthusiastic—sources of assistance in the diaspora community. This community already has networks within the country and can often help establish capacity.

FIGURE VII.1: FDI AS A PERCENT OF GDP



AVAILABLE RAPID ASSESSMENT TOOLS

DAI. 2004. Enterprise Growth Initiatives: Strategic Directions and Options, pp. 27-28 in *Environmental Scanning and GAP Analysis Handbook.* USAID/EGAT/EG. This type of analysis, along with other analysis tools, can be found at the Business Growth Initiative Web site at https:// www.businessgrowthinitiative.org/ResourceCenter/Documents.

Kaplinsky, Raphael and Mike Morris. "Value Chain Analysis." *A Handbook for Value Chain Research.* International Development Research Centre (IDRC). This handbook details the process of conducting a value chain analysis. The USAID Microlinks site at http:// www.microlinks.org/ev_en.php?ID=9652_201&ID2=DO_TOPIC also provides an extensive number of documents with examples of value chain analysis on specific sectors in different countries.

Meyer-Stramer, Jörg. Participatory Appraisal of Competitive Advantage (PACA). See www.mesopartner.com. As described on the Web site, PACA "…combines competitiveness concepts with the principles of rapid/participatory appraisal in order to identify quickly implementable activities to stimulate a local economy. It is not aiming at grand strategies and big projects, but rather at practical approaches to remedying local market failures which so far stand in the way of business growth."

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VIII. AGRICULTURE

> ***Overarching Objective:*** *reverse the disruption of food production and agricultural markets, and put the agriculture sector back onto a growth path*

Agriculture[1] generally offers the most promising immediate source of livelihood for the majority of the population in many post-conflict countries; for this reason, it is a critical aspect of early recovery efforts. Restoring agriculture (rural security conditions permitting) can have a broad impact on growth and offers widespread benefits to returning refugees, internally displaced persons (IDPs), and other vulnerable groups.

POLITICAL AND SOCIAL ISSUES

Returnees are primarily concerned about going home to a safe environment to resume their livelihoods and rebuild their communities. Farmers want to return to their farms; others seek wage-paying employment to support their families. Returning to familiar surroundings reduces stress and anxiety, and provides families with an opportunity to assess the conflict's impact on family resources, check on the condition of farm lands laid fallow during the conflict, and identify available nonfarm job opportunities. Some returnees may not want to go back to farming lifestyles. They will need new vocational and technical skills, if they are to contribute productively to the economy and society. To ensure that these workers have a stake in peace, it is critically important that they be reintegrated into an expanding peacetime economy through viable market-oriented jobs.

Post-conflict countries must consider social and political-economic dimensions when developing agricultural policies as part of their recovery strategies. Donors, too, must ground their investments and policy advice in political-economic analysis. In economic policy and investment planning, post-conflict countries should be prepared to accept and defend some short-term imbalances among geographic areas, economic sectors, and institutions. Certain public investments generate higher returns than others. Hence, some sectors, institutions, and geographic areas will receive a greater share of initial investments. These investments, some argue, improve productivity and stimulate further growth, which then expands into less-favored areas and sectors. Opponents counter that excluding certain areas or sectors contravenes an "equitable" allocation of investment resources. Imbalances can be tolerated if they are a question of timing and sequencing, and not a long-term or willful neglect of some areas or sectors. Nonetheless, post-conflict countries should avoid extreme policy or aid-flow imbalances that favor some areas or sectors ("aid darlings") over others ("aid orphans").

> **The recovery of agricultural production and market development can move communities more rapidly from relief dependency to independent livelihood security.**

[1] While many examples in this chapter will be based on crops, "agriculture" refers to food crops, fiber crops, tree crops, animal husbandry, and aquaculture.

KEY TRADE-OFFS

In the early post-conflict period, formal authorities often have very little control over daily activities in rural communities. Institutions are weak. Laws that applied before the conflict are unevenly enforced. Markets are missing, segmented or thin, and unpredictable. Transaction costs are high. Risks and uncertainties are pervasive and there may be some rural areas where conflict persists. In this chaotic context, quick donor decisions may be required to resolve immediate issues. Donors may need to make decisions on the basis of specific trade-offs that are much more acute than in stable developing countries. Examples of such key trade-offs include *short-term vs. long-term, short term vs. long term, effectiveness vs. efficiency,* and *window of opportunity vs. absorptive capacity.*

Short term vs. long term

A key long-term objective is to reduce dependence on donated food and other relief services. In the short term, the objective of saving lives by preventing starvation and hunger trumps the longer-term objective of restoring farmers' livelihoods by promoting local food production and marketing. As local food production declines during a conflict, the urgent need to deliver food in a timely fashion pre-empts concerns about the impact of donated food on local production cycles. Often, as the conflict ends, donors are still delivering relief supplies and food staples (e.g., rice, oil, beans, and canned meat) to urban feeding centers and to remote pockets of IDPs. As local production improves after the conflict, ongoing donor food imports may glut the local market, depress domestic crop prices, and create undesirable disincentives to local farm production. In this way, short-term relief activities overlap with long-term market development efforts.

There are market-oriented ways to ease the transition from short-term relief to longer-term agricultural development. In the early post-conflict period, it becomes increasingly important to reduce imports of donor food and other relief supplies that could be produced locally, to ensure that these imports do not discourage local agricultural production and depress farm incomes. As soon as possible, households should be weaned off donor-provided food. NGOs and PVOs have effective methods to assess household conditions and accomplish this goal in both urban and rural communities.

One solution with positive, long-term benefits is to strengthen markets through "market integrated relief" approaches, which work with market providers instead of setting up parallel relief supply channels. With these approaches, donors seek to work with private-sector partners. They buy relief supplies from local and regional vendors as much as possible and focus on "demand" subsidies instead of "supply" subsidies. In addition, food donations can be channeled through market mechanisms. For example, the PL 480 Title II monetization program could initially be used to assist millers, grain dealers, and small firms to purchase donated bulk wheat to make flour and feed grain for the animal feed industry. Donors could also support community-based programs by helping wholesalers and retailers purchase rice, vegetable oil, beans, and nonfood items that can be traded in local bazaars and markets. Box VIII.1 on the next page contains an example of how agricultural markets were jump-started and production incentives improved in southern Sudan in the 1990s.[2]

In the longer term, it is important to improve the social, economic, and environmental sustainability of agriculture. Immediately after a conflict, getting agriculture moving again often depends on a return to traditional subsistence farming and the use of existing technologies without regard to their longer-term

[2] Anderson, et al. *Evaluation of U.S. Humanitarian Assistance Strategy for Southern Sudan* (1995). Salinas and d'Silva, "Evolution of a Transition Strategy and Lessons Learned: USAID Funded Activities in the West Bank of Southern Sudan, 1993 to 1999" (1999). SUPRAID, BYDA and Concern Worldwide, "Trading for Peace" (2004). John Marks, USAID/Sudan, personal communication, 2007.

efficiency and sustainability. In addition to immediate needs for crop seeds and tools, short-term grants also may be needed to restock livestock herds, flocks, and fisheries to resume viable livelihoods. In the longer term, sustainable agriculture depends on crop yields, the size of livestock herds, and the level of revenue that livestock and crops can generate through sale. Revenue generated by these sales is usually spent first on increasing acreage, herd size, and income. The increased income then helps households pay for their nonfarm needs.

BOX VIII.1 JUMP-STARTING WARTIME MARKETS IN SOUTHERN SUDAN

A variety of programs successfully jump-started local market economies in southern Sudan during the waning years of conflict and in the post-conflict years. These initiatives helped re-establish the business capacities of farmers, traders, and transporters. Evolving during years of unusual and changing circumstances, they made it possible for currency to circulate and for trade goods to reach nearly all corners of southern Sudan.

Historically, southern Sudan has been underdeveloped, has not had market traditions, and has used a barter system of exchange. Most southern Sudanese did not handle cash and had no access to markets. During the war years, in particular, markets were limited primarily to garrison towns. All goods arrived on military flights from Khartoum and were sold mainly to Sudanese government employees. Prices were greatly distorted and markets had few linkages with the surrounding countryside.

When humanitarian NGOs began relief operations in the early 1990s, their workers were paid in soap and salt because cash held no value in rural areas. After the SPLA captured some of the major towns in Western Equatoria in the mid to late 1990s, things started to change. OFDA-funded NGO programs began to open up isolated areas and stimulate local economies. NGO recovery programs initially focused on barter and agriculture, airlifting basic consumer items (such as salt, soap, blankets, buckets, and bicycles) to major towns and then exchanging those items for seed and surplus grain grown by local farmers. The seeds and grain were subsequently sold to NGOs carrying out relief operations elsewhere in Southern Sudan. Over time, barter exchanges gave way to cash transactions that helped establish the "right" price relationships. One USAID approach to developing cash markets involved selling U.S. emergency food-aid wheat in Uganda and using the Ugandan shilling proceeds to buy local grain in Southern Sudan. This program subsequently expanded into other market-supporting activities.

In later years, locally initiated "Peace Committees" set up eight "Peace Markets" in greater Bahr el Ghazal. These markets enabled northerners and southerners to put aside their political and social differences and exchange consumer goods and livestock in relative security. The Peace Committees negotiated rules for the Peace Markets, such as a prohibition on weapons within designated market areas. The Peace Markets enjoyed several years of relative success in the years immediately preceding the Comprehensive Peace Agreement of December 2004, because each side perceived benefits from continued trade.

Key lessons learned from the programs in Southern Sudan include:

- Revitalizing farmer cooperatives can increase the effectiveness of local grain purchases by helping amass grain from individual farmers, resulting in savings for purchasers and higher unit prices for farmers.
- Encouraging surplus food production is unsustainable without steady market demand, even when stimulated by NGOs during emergency and transition phases.
- Restarting markets requires simultaneous attention to improving roads that reduce transport costs, increase volumes, and lower prices.

Programs to improve the availability of credit in rural communities, although important for sustainable agriculture, are a longer-term priority. As prospects improve for lending and collection of repayments in post-conflict rural areas, donors will find more favorable conditions for rehabilitating, assisting, or launching bank and nonbank programs to improve access to credit for rural communities. Credit-access programs accelerate social and economic activities and bring greater cohesion within communities. Such programs also can help identify vulnerabilities and lay out other arable production areas to improve environmentally sound expansion of pastures, woodlots, and food-crop production.

Effective vs. efficient

Early efforts to put arable land back into production should emphasize effectiveness over efficiency. Beginning with the country's major agricultural production areas, donors should target rural communities and farms for assistance. With due consideration of environmental and resource management concerns, donors' first steps toward generating employment should emphasize job opportunities that would put arable land back into production. Because of the typical lag in the rebound of private investment in farming, donor financing may be needed for such tasks as rebuilding warehousing and feeder roads, and repairing water delivery systems. Donors' investment decisions should be based upon how effective they would be in bringing land back under cultivation or pasture, even if their economic efficiency might prove to be marginal.

One technique for getting arable land back into production is to identify small and medium enterprises and/or cooperatives which—prior to the conflict—supplied agricultural inputs or processing and other services. These local institutions should be evaluated and possibly supported with one-time grants to restart operations or, if there are viable local financial institutions, with lines of credit for the purchase and supply of farming inputs. To provide farmers with access to improved seeds and other inputs that are in short supply after disruptions in supply, one option would be to give farmers input vouchers. Box VIII.2 describes how seed vouchers and seed fairs have been used successfully to provide farmers with the seeds of their choice and to get land back into production.[3]

Box VIII.2 Seed Vouchers and Seed Fairs: Often Better than Direct Distribution

Both seed fairs and seed vouchers connect farmers who have seeds to barter or sell with those who need them. Seed sales increase the income of the sellers, who are usually farmers themselves and are often women. Experience shows that prices generally are within expected market ranges. Seed sales also can have a positive multiplier effect on the local economy. Unlike direct seed distribution to passive recipients, these alternative approaches empower farming households, providing them with opportunities to make their own choices.

Knowledgeable farmers are able to distinguish among local seed varieties to obtain desired seed characteristics. These farmers are unlikely to plant newly introduced outside seed until they personally have grown it and gauged its performance. For this reason, farmers overwhelmingly prefer their own seed varieties, and will save them even in years of crisis, supplementing their supply through barter or purchase. In post-conflict settings, most seed is likely to come from these informal arrangements, which vary by crop and region. Except in cases of widespread or prolonged conflict, it is a mistake to assume that production failure necessarily equates to seed scarcity.

Outside seeds distributed for post-conflict recovery often are unsuitable to local conditions and fail. The most effective—and hence, most helpful—seed-distribution systems supply seeds that farmers have problems acquiring. The best source of such seeds is through the farmer seed system itself.

Recognizing that donor grant-distribution of seeds may undermine farmer seed systems and local markets, more and more international relief agencies and NGOs are experimenting with seed fairs, where farmers can buy or exchange local seeds directly with other farmers. These seed varieties are time-tested, adapted to local growing conditions, and well-known. Farmer reputation is the most critical guarantee of quality. Another recovery option is the use of vouchers distributed by sponsoring NGOs to targeted households. The households can "spend" the face value of their vouchers at participating retail outlets for the seeds of their choice (usually local-variety, farmer-saved seed) to jump-start the system.

The use of local seeds requires a "seed security assessment" to ascertain 1) that seed-source households in the area have sufficient seeds (availability), 2) that these seeds are safely stored and acceptable for the next growing season (quality), 3) that the seed-source households are able to meet their own needs before selling or bartering their seeds, and 4) that needy households have the means to buy or barter for seeds (access).

[3] Jones, Richard B., Paula Bramel, Catherine Longley and Tom Remington. "The Need to Look Beyond the Production and Provision of Relief Seed: Experiences from Southern Sudan." *Disasters,* 26 (4) (2002). Walsh, Stephen, Bonaventure Ngendahayo and Christophe Droeven. "CRS/Burundi: Experience with Seed Vouchers and Fairs in Kirundo Province." Bramel, Paula, Tom Remington and Melody McNeil, eds. *CRS Seed Vouchers & Fairs: Using Markets in Disaster Response* (Nairobi: CRS East Africa, 2004).

A key long-term priority is to expand trade opportunities and build the trade capacity of agricultural producers and rural industries. In the early post-conflict years, donors should focus on reducing dependence on aid, rebuilding the productive sector in agriculture, and generating jobs. Later, as the economy stabilizes and land begins to come back into production, donors must address issues such as the transition from food importer to food exporter (e.g., in Mozambique). Where it might earlier have been *effective* to take shortcuts to get the agricultural economy moving, it is now imperative that long-term initiatives emphasize increasing levels of *efficiency*, to enhance agricultural trade capacity. A major objective should be to increase efficiency along the parts of the value chain that help private-sector investors and operators reclaim lost market share.

Donors can help increase efficiency by establishing a dialogue with the host government, private-sector processors, and producers to reinforce the importance of sanitary, phytosanitary, and quality standards for agricultural products exported to regional or international markets. Another tactic for improving efficiency is financial sector interventions, including working with local banks and producer associations to develop warehouse receipt programs, loans to producer associations, and microfinance programs.

In most cases, public provision of services—such as feeder and trunk roads to ensure access to markets, and irrigation and electricity—remains a priority for improving agricultural sector productivity. In other cases, private provision may be more effective. In Afghanistan, for example, a joint approach to resurrecting veterinary services, which had collapsed during conflict, involved international donors and both the public and private sectors.[4] (See Box VIII.3 on the following page.)

Window of opportunity vs. absorptive capacity

A critical long-term objective for agricultural sector development is to mobilize science and improve technology. Conflict seriously weakens a country's capacity for agricultural innovation. Nonetheless, there are often many opportunities to introduce new plant varieties and improve production processes by making use of the remaining capacity. Immediately after a conflict, donors should work with agricultural NGOs and government institutions to identify available, off-the-shelf technology that can be applied and adapted to local agricultural conditions. This information should be disseminated through NGO and government outreach programs. In the medium term (three to ten years), donors should help rebuild local capacity with assistance from specialized international institutions. Stronger capacity will enable host-country institutions to use innovative science and technology applications to solve pressing productivity and enabling-environment challenges, such as capacity-building and policy issues.

An assistance program in Mindanao introduced improved practices for rice and maize production and seaweed harvesting. This program's successful combination of input and extension services may be applicable in other post-conflict situations. (See Box VI.2 for more information.)

It is important to strengthen agricultural training, education, outreach, and adaptive research, but first, capacity must be restored. Early assessments should provide information about the condition of institutions—both government and private—that provide agricultural extension and training services. These institutions are likely to be in very poor condition; their mission and scope of work may need to be reassessed. Because ministries in post-conflict countries typically have a scarcity of highly capable staff, training requirements are likely to be extensive. The government, however, must balance its long-term need for trained personnel with its need to establish or restore a functioning ministry.

[4] Miller, Dan and Dave Sherman. "Privatization of Veterinary Services: Development that Works." (USAID/Afghanistan, January 2006). Dutch Committee for Afghanistan—Veterinary Programmes (DCA-VET). "Continuation of the Afghan Veterinary Privatization Effort to Secure Sustainability of the Veterinary Field Unit (VFU) System established under USAID-RAMP." http://www.dca-vet.nl/DCA/documents/07JansummarysheetASAPproject_000.pdf.

Governments often are reluctant to send employees away for long-term training. This is particularly true right after a conflict, when talent is scarce and the absence of key staff would impair the ministry's functioning. Given this limited civil service capacity, approaches that utilize public-private collaboration should be given priority. Support from foreign universities and technical institutions, expatriate contractors, international research centers (CGIARs), and donors can play a vital role.

BOX VIII.3 PRIVATIZING VETERINARY SERVICES DURING AND AFTER CONFLICT IN AFGHANISTAN

In Afghanistan, a country with continuing conflict where public services remain weak and under-funded, USAID is supporting private veterinary services to address livestock health issues. Prior to the Soviet invasion in 1979, Afghanistan assigned all veterinary activities to the public sector on the premises that: 1) the rural poor deserved free veterinary care for their livestock, and 2) all veterinary services would be provided by the government. Unfortunately, reality fell far short of the ideal. Without a budget for vehicles, fuel, medicines, or vaccines, government veterinarians rarely reached the areas where animals were concentrated. Moreover, when the Soviet army invaded and backed the government in Kabul, government veterinarians had to flee their posts to avoid being identified with the occupiers. In a short period, Afghanistan went from having ineffective public-sector veterinary services to having none at all. Privatized veterinary services emerged out of necessity during the Soviet occupation.

Recognizing the central importance of animals and animal health to rural livelihoods, a number of international agencies and NGOs—most notably UNDP-OPS, the Food and Agriculture Organization (FAO), the Dutch Committee for Afghanistan, and Mercy Corps International—stepped in to provide farmers and herders with basic veterinary services. These organizations

- offered two to four weeks of training for basic veterinary workers (BVWs) and five to six months of training for para-veterinarians (para-vets);
- established district-based veterinary field units (VFUs), where field staff could obtain reliable, high-quality vaccines and medicines, report diseases, and seek advice; and—perhaps most importantly
- established a fee-for-service policy to cover the costs of sustaining a reliable veterinary service delivery system.

Under this system, paraprofessionals paid for their medicines at the VFUs, charged farmers for their services, and earned money to return to the VFUs for new supplies.

Privatized veterinary services took hold in Afghanistan. Building on earlier efforts, the FAO set up a unified, national VFU system in 1994. By 2000, hundreds of para-vets and BVWs had been trained, and millions of vaccines and medicines had been delivered to farmers and herders on a fee-for-service basis. After FAO funding ended and Afghanistan suffered one of its worst droughts, USAID's Rebuilding Agricultural Markets Program (2003-2006) helped rebuild private veterinary services.

Through outreach and extension efforts, livestock owners came to understand the value of preventive veterinary interventions in reducing livestock mortality, helping replenish diminished herds, and improving incomes by increasing the number of animals that could be brought to market. It became clear that high school graduates could be effectively trained as para-vets to perform basic animal health care services, such as accurately recognizing and properly treating common livestock diseases, or could—if necessary—make referrals to more experienced veterinarians.

LESSONS LEARNED

The available literature provides a number of lessons learned that apply to the agricultural and rural sectors in post-conflict environments. Some of the most significant are listed below.

- Conflicts have significant effects on production, distribution, marketing, processing, and retailing activities that generate income and secure a sustainable livelihood in the agricultural sector and rural areas.

- Markets are resilient. Prolonged conflict changes agricultural markets but does not destroy them. Recovery programs can help markets function better, thereby helping households cope with adversity or recover from conflict.

- Humanitarian relief activities often inadvertently distort agricultural markets and private-sector production, and often unintentionally create new vulnerabilities and dependencies.

- Agricultural production recovery and market development (an approach to enterprise development, livelihood security, and economic growth) can move communities more rapidly from relief dependency to independent livelihood security.

- Agricultural production recovery and market development can be undertaken almost immediately after a crisis or in the midst of low-intensity crisis, as long as populations are relatively stable and security is reasonable. (See Box VIII.4.)

- Agricultural and rural market development programs, even in post-crisis settings, should focus on activities directly relevant to specific market disruptions, particularly when the market consists of small enterprises.

- In the agricultural sector, grant programs need to be analyzed to avoid market distortions that can be caused by grants. Such programs should be timed with production seasonality and local vendors in mind.

Programming Options

The trade-offs and lessons learned described above can help donors program resources effectively to guide economic stabilization, recovery, and capacity-building in rural areas and the agricultural sector. Box VIII.4 below provides a quick guide to critical and priority steps for reviving the agricultural sector after a conflict.

Box VIII.4 Critical Steps in the Early Post-Conflict Period

1. *Get agricultural markets functioning:* This requires a secure environment (protection of people and property, and marketplaces for conducting business), safe and open roads (de-mining and removing conflict debris), and basic transportation, communications, and financial systems.

2. *Get in step with seasonality:* Prepare immediately for the next production and harvest season, using market-led systems for input and output marketing.

    - If the effort begins before the planting season, help returning farmers begin family gardens, subsistence farming, and cash cropping, as conditions permit.

    - If refugees and IDPs return late in the planting season, register households for resettlement assistance to ensure access to food, shelter, medical, and other essential services. Be prepared to support these households (or those who support them) until the following harvest period.

3. *Start planning for long-term recovery right away:* Take steps for long-term recovery and growth, including economic and agricultural institution-building, from the very beginning as part of the emergency and post-conflict relief planning and the transition to sustainable growth.

Programming options are plentiful and should be chosen to address issues that have been identified as high-priority. Specific options include the following:

Restore the related enabling environment outside of agriculture:

- resettle IDPs and help reintegrate them into the economy

- ensure an acceptable level of food security (availability, access, utilization)
- transition from supply-driven relief to demand-driven development
- achieve quick, tangible benefits that buy time and stability for long-term activities

Restore physical infrastructure (roads, railroads, ports, power, water, etc.) needed for agriculture:

- restore critical private installations (warehouses, packing sheds, processing plants)
- restore key institutional infrastructure (extension, sanitary, and phytosanitary services) that support agriculture
- stimulate formation and build the capacity of private organizations (grower/processor/exporter associations, trade associations)
- get input and output markets moving by allowing imports, ensuring that inputs from reputable sources are not hindered, removing unnecessary restrictions on the receipt of inputs and the distribution of outputs, and reducing transaction costs and time
- rebuild the monitoring and enforcement capacity of key regulatory authorities (food safety, animal health, plant health, environmental protection)

Restart and rehabilitate critical industries, clusters, and value chains in the agriculture sector and rural areas:

- identify, prioritize, and then provide targeted support to crops and industries that in the past contributed significantly to agricultural-based income and employment
- identify, prioritize, then provide targeted support to value chains that contributed (or may contribute) the most to value-added, employment, and/or export earnings
- revive rural financial services and lending

Recover productivity and enhance competitiveness in agriculture:

- identify and address the most critical constraints to greater productivity (e.g., lack of high-quality planting materials, lack of access to fertilizer, absence of agricultural credit, poor condition of farm-to-market roads, loss of local agricultural know-how, etc.)
- restore supply chains to the farm for physical inputs, equipment, and services
- identify and address the most critical issues in competitiveness (e.g., low yields, low quality, lack of consistency of supply, lack of familiarity with market needs or expectations, poor linkages with the marketplace)

AVAILABLE RAPID ASSESSMENT TOOLS

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IX. BANKING AND FINANCE

Overarching Objective: *ensure that the country has the basic capacity to carry out financial transactions*

The health of banking and the financial sector is critical to a post-conflict economy's recovery and growth. The country must have the capacity to carry out financial transactions beyond a simple cash and barter economy. To achieve this objective, the government must have the capacity to make payments and the central bank must function effectively (see Macroeconomic Foundations, Chapter V). In addition, public and private financial institutions—both formal and informal—must be able to service the financial transaction needs of households and enterprises as they renew their pre-conflict activities or enter new markets.

Donors should help establish a functioning financial sector that provides:

- *a store of value* other than in goods (i.e., a stable currency, whether domestic or foreign, which is accepted as legal tender);
- *safety for savings,* with institutions that are trusted deposit-takers so households can protect their financial savings; and
- *payment mechanisms*—efficient, accessible means to pay for goods and services through the formal financial system, in all significant trading centers. Payment mechanisms facilitate the exchange of value required for commerce and enable the government to pay its employees—particularly teachers, health care workers, and police—outside of the capital.

POLITICAL AND SOCIAL ISSUES

The public must have confidence in the post-conflict government's ability to manage the money supply and oversee the financial sector. Economic growth requires a functioning financial sector; a functioning financial sector requires the public and the business community to have confidence in the government's capacity to carry out its basic financial management functions: managing monetary policy, operating an independent central bank, and overseeing banking and financial operations. In the aftermath of a conflict, the new government may need time to earn this confidence. The donor community can assist by ensuring that the government understands how important sound and prudent financial management is to post-conflict recovery, and by helping build its capacity to carry out the government's basic financial management functions and communicate its policies clearly and credibly to the public.

KEY TRADE-OFFS

Donors assisting post-conflict countries must make decisions quickly, on the basis of specific trade-offs that are much more acute than in stable developing countries. In providing banking and finance assistance, the key trade-offs are *effectiveness vs. efficiency* and *short term vs. long term*.

Effective vs. efficient

Core financial services, such as deposit-taking and the facilitation of payments, must be established at a very early stage in the recovery. Recovering economies do not have the luxury of time to design and implement perfect solutions. In addition, they may not have the absorptive capacity for such solutions. It is much quicker and more effective to re-establish an existing, well-understood system, using available human resources, than it is to import unfamiliar technology or practices.

Resurrecting state-owned banks may be part of an effective short-term approach in countries where state banks have 1) a legitimate base upon which to build,[1] 2) a history as private institutions, and/or 3) a branch network that is not likely to be quickly duplicated by the private sector. It should be made clear, however, that state banks (as well as other local banks) will not be protected from competition or from takeovers by new foreign entrants. In Bosnia and Kosovo, for example, foreign banks entered (mostly through mergers or acquisitions) soon after the end of conflict; they provided safer, more efficient retail banking services than had been available previously.

Short term vs. long term

The expansion of lending is a longer-term objective, which takes place as capacity in the financial and commercial legal sectors improves. Past experience has shown that the growth of bank credit to the private sector evolves slowly in the post-conflict period. Forcing credit out in an environment that is not conducive to loan recovery and where credit skills are missing can actually undermine financial sector and economic development by misallocating scarce resources. In contrast to most developing countries, post-conflict states seldom offer a favorable environment for the expansion of retail credit. There often is a limited history of credit discipline. Loan recovery frequently is problematic as well, and lenders' risk-management skills are often poorly developed. Before encouraging an expansion of lending, donors should help the host country put in place the basic prerequisites for such an expansion: capable financial institutions, an effective legal and judicial foundation for finance, and a supportive business environment. While local businesses may press for an expansion of credit, it often is not vital to their immediate needs.

FIGURE IX.1 DOMESTIC CREDIT TO PRIVATE SECTOR AS A PERCENT OF GDP

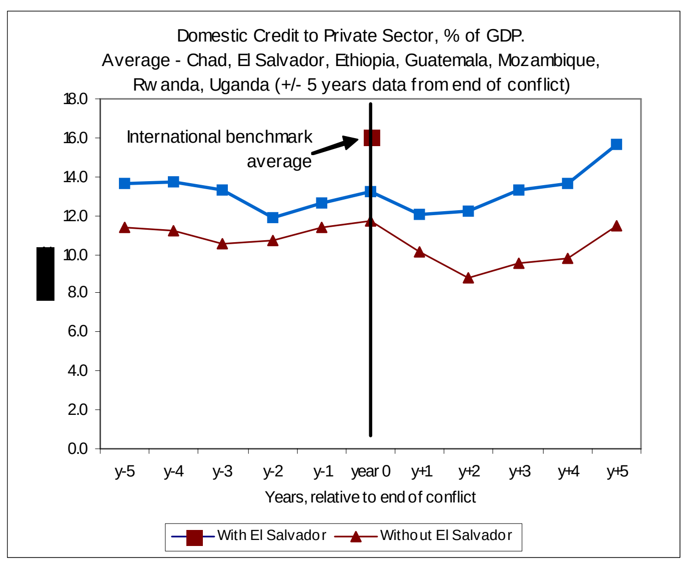

Figure XI.1 to the right illustrates the ratio of private sector credit to GDP in countries where data is available for at least five years before and after the end of an intense conflict (going back to 1985). When the conflict ended, the ratio typically was well below the international benchmark (by income group) and was difficult to revive, despite the efforts of donors. During the post-conflict phase, El Salvador was the only case where better-than-average conditions allowed bank credit to the private sector to surge from 23 to 40 percent of GDP

[1] However, merging two dysfunctional state banks that historically had been competitors and had different cultures might seem "efficient," but in fact may disrupt both, undermining rebuilding efforts and limiting future competition.

over five years. For the other six countries in the group, the average credit ratio after five years was roughly the same as at the beginning of the post-conflict period (bottom line in the graph).

PROGRAMMING OPTIONS

Rebuilding the basic financial services sector is a high priority. The financial sector is critical for economic rebuilding, and post-conflict countries frequently have had significant deteriorations in their banking system and in their financial sector in general. The immediate priorities for donor programs to rehabilitate the financial system are:

- *Diagnose the financial sector's performance.* Determine how well the financial sector is supporting the economy and how its institutions are functioning. Existing pre-conflict analyses or rapid post-conflict reports by the IMF or World Bank may identify structural issues.
- *Develop implementation plans* for three critical functions: store of value, savings, and payments.
- *Develop market oversight* through bank supervision. This will be a long-term process, with an early focus on the solvency of existing banking institutions. (See Chapter V.B: Monetary Policy and Institutions.)

USAID has significant experience helping countries develop effective banking and finance sectors. In a post-conflict economy, donor assistance can reinforce the financial sector's capacity to perform its payments role, including: 1) enabling the government to pay employees outside of the capital, and 2) enabling traders to pay for the imports needed for investment and consumption during early rebuilding stages. Donor assistance can also help financial institutions resume their intermediation role, channeling savings to rebuilding enterprises so they can once again invest in their businesses.

A diagnostic assessment should be carried out soon after basic monetary management and central banking functions have been restored. The assessment, which can be used to chart a strategy for developing a financially healthy banking sector, should be completed quickly so that rebuilding can begin. The diagnostic will likely need to include the following:

- *External audits or regulatory diagnostics of the main commercial bank*s, to determine which institutions are salvageable and whether some institutions need to be restructured, recapitalized, sold, or liquidated. If the country's bank supervision and audit functions are ineffectual (as is often the case post-conflict), the audits should be done by foreign analysts.

- *An evaluation of the central bank's regulatory capacity*, to determine if:
  - the rules that govern entry into the banking sector ensure fit and proper ownership and management, adequate capitalization, and good operating plans
  - disclosure practices are adequate
  - bank inspectors carry out frequent onsite inspections, and if their enforcement powers are adequate to resolve market spoilers
  - regulators, supervisors, and inspectors are well-qualified
  - financial contracts are enforceable by creditors and whether collateral can be realized rapidly, predictably, and inexpensively

Systemically important banks may need to be strengthened or even rebuilt. Donors may need to assist with remedies such as improving or restoring the operating and risk-management capacity of major banks, particularly those with national branch systems that could serve large segments of the commercially active population. Private and state-owned commercial banks typically are the most important financial institutions, although years of conflict may have saddled them with unusually large and significant handicaps, such as:

- *a portfolio of politically directed loans*, often at concessionary interest rates. This portfolio often includes old loans that are now non-performing and (possibly) more recent loans to appease leaders of the new government.
- *collateral claims that cannot be enforced* through the court system and may render the related loans uncollectible. In such circumstances, leasing—based on an appropriate lease law—may be an effective substitute for collateralized credit.
- *insider loans* to managers or, often in the case of state-owned banks, loans to relatives of bank loan officers or to phantom companies.
- *degraded or outdated operating systems,* internal controls, management information systems, and weak staff capacity.

Banks in post-conflict countries are likely to have lost significant portions of their best staff (including to emigration) and may not have enough expertise left to function effectively. Key records may have been lost.

If banking services have become scarce, operating margins for existing banks may be high, reflecting a wide differential between market rates of interest on deposits and those on loans or other bank assets. This may make some banks—even those with weak operating capacity—quite profitable, creating a supportive environment for donor-funded rehabilitation efforts. Other banks may be less profitable, needing a great deal more donor assistance for effective rehabilitation. In the longer term, donors may need to engage in more significant restructuring, including preparing state-owned banks for privatization.

An important element of the financial sector strategy may be to enable international banks to obtain operating licenses in the host country. This would permit international banks to provide takeover management for state banks being privatized or for unsound local private banks that are too weak to continue operations. Also, international banks can help bring the practices of locally owned commercial banks up to any new standards required by the host country's central bank. In developing countries, international banks often lead the efforts of the local bankers' association to provide ongoing professional training for local bankers. Market demand helps to quickly distribute the local staff members who have been trained by international banks throughout the local banking community. Finally, an established international bank has external regulatory support from the central bank/regulator of its home country. Interaction between the host-country and home-country central banks/regulators (to jointly supervise the international bank's operations) may help raise standards in the host-country central bank.

Donors can play an important role in building the country's financial regulatory capacity. Parallel with the initial cleanup of weak banks, the host country's central bank is likely to need significant assistance to strengthen bank regulation and supervision. It also may need targeted technical assistance to build or rebuild staff capacity. USAID has had wide experience in this area, often drawing on the staff and expertise of U.S. bank regulatory agencies to support on- and off-site supervision and to assist with problem bank resolution.

Experience has shown that nonbank financial institutions pose consumer protection risks in post-conflict environments. The capacity for proper financial regulation is vital for avoiding potential crises caused by the proliferation of new financial fads or unsound institutions. Long-established informal financial systems, however (such as the hawala system)[2], will continue to function alongside the formal system.

Expanding the availability of financial services, including credit, is a medium-term priority. Donor financing of credit and reinvigorated private lending are not likely to be realistic early goals—the basic financial system should be functioning properly before donors promote expanded availability of credit. It generally is more appropriate for donors to provide financial assistance to the conflict-affected population and to small businesses through grants (either cash or in-kind) rather than loans, even beyond the immediate relief phase of assistance.

Microfinance institutions may be part of an effective post-conflict response, even if they do not have enough aggregate economic impact to stimulate overall growth. Relative to the commercial banking system, microfinance institutions (MFIs) form only a small part of the financial sector in most countries, but they usually serve disadvantaged populations without access to the formal banking sector. For this reason, MFIs—when they develop a substantial footing in a post-conflict country—may provide a very useful channel for reaching otherwise "unbanked" target populations. In developing programs in this area, donors should consider a variety of issues. Given its size (e.g., total outstanding loans in relation to GDP), does the microfinance network have the potential to have a wide impact on overall economic production and employment? Does it provide financial services to people outside the formal economy who perceive themselves to be unfairly treated and thus may support a return to conflict? Afghanistan, for example, had no microcredit lenders in 2001. By the 2004-2006 period, however, 13 MFIs had expanded to serve 200,000 active clients in 20 provinces. This experience led USAID to support a major expansion of MFI operations.

If donors choose to carry out microfinance initiatives, they should be part of a financial-sector-wide assistance program. Microfinance alone is not a substitute for reconstituting the country's core banking capacity. Nonetheless, as argued by Frasier and Bne Saad (2003), it can be a "…useful and effective tool in the post-conflict recovery phase…providing…access to financial services when other providers have ceased to operate. [Microfinance]…enables the self-employed to resume economic activity, supports the reconstruction of the financial system, and facilitates a smooth transition from short-term humanitarian assistance to longer-term development."[3] Not all researchers, however, have come to the same conclusion. A 2003 study funded by DfID, for example, concluded that "…in practice, post conflict microfinance has been disappointing, with limited outreach and high delinquency rates leading to eventual collapse; and unlike microfinance in more stable contexts, there has been little field-based investigation into these problems."[4] Donors should consider the distributional effects of microfinance and whether emphasis on MFI development might divert resources from financial-sector activities that would have a greater impact.

When supporting microfinance, donors must ensure that relief services and microfinance services are kept separate. In the immediate aftermath of a conflict, the NGOs supporting MFIs often are the same NGOs that provide humanitarian assistance. This can be a practical arrangement, as these organizations typically are familiar with local clients, enabling them to quickly identify those with the greatest needs. Donors must make it clear, however, that grant assistance should never be offered as forgivable loans; this practice can have negative long-term effects on future loan repayment. NGOs providing both microfinance and grants must clearly separate the two activities to avoid confusing clients about their loan repayment obligations.

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[2] Hawala (also known as hundi) is an informal value-transfer system, based on performance and honor in a huge network of money brokers who are primarily located in the Middle East, Africa, and Asia.

[3] Frasier, Susan and Bne Saad, Majda. Microfinance in Post-Conflict Situations: A Case Study of Mozambique (2003).

[4] Williams, Alison. *Post Conflict Microfinance Research Summary* (Dublin: Concern Worldwide, 2003).

In the longer term, donors should seek to cut the cost and increase the safety of remittances. As the formal financial system expands and improves, donors should encourage the channeling of remittances from the diaspora population through the formal banking system. Remittances may constitute a major resource transfer, important both for the livelihoods of conflict-affected households and for reviving local economic activities. Most incoming transfers will take place through informal channels. To facilitate a greater flow of remittances through the formal banking system, their cost should be reduced and their safety increased. This should be accomplished by building the capacity of formal banks, credit unions, and MFIs to handle remittance transactions efficiently. Donor interventions should aim at "banking the unbanked" through depositing a portion of the remittance payment into a bank account or using remittance flows as collateral to access other financial products offered by financial institutions.

AVAILABLE RAPID ASSESSMENT TOOLS

Highly sophisticated assessment tools, such as the World Bank's 2005 publication, *Financial Sector Assessment: A Handbook*, are available. This 484-page handbook and other available assessment tools are primarily for teams of financial sector experts.

X. TRADE POLICY AND INSTITUTIONS

> ***Overarching Objective:*** *ensure that trade in goods and services increases, contributing to economic growth*
>
> *In most cases, increasing trade means attempting to achieve the most liberal trade regime possible, given post-conflict security issues and critical government revenue requirements.*

Many of the benefits of global trade are available to post-conflict countries, as long as the right policies and institutions are in place. Open economies grow faster and create opportunities to reduce poverty, particularly when trade liberalization is accompanied by a sound investment climate that encourages labor and capital to redeploy to opportunities. International trade and investment enable specialization, encourage economies of scale, spur the transfer of technology, and create more competitive domestic markets. These effects yield real cost reductions, which are crucial for creating wage and income growth. Establishing the policies and functioning institutions needed to facilitate trade in the wake of a conflict presents unique challenges, which require trade assistance to be prioritized and sequenced differently than it is in stable developing countries.

POLITICAL AND SOCIAL ISSUES

Post-conflict countries typically face serious border management challenges. Border security problems are particularly acute in Iraq, Afghanistan, and Somalia. To a lesser extent, border management and security present challenges in Nepal and Sudan. The control of the illegal drug trade poses special border management difficulties in Haiti, Colombia, and Afghanistan.

The difficulty of improving border management should not be underestimated; border management must receive appropriate attention early in the post-conflict period.

The need for security at the border often requires a heavy military or law enforcement presence. To stop weapons and contraband, customs and other law enforcement procedures require routine inspection of most cargo crossing the border. Obviously, such inspections may slow down legitimate trade. To reduce delays and avoid a drag on economic growth from poorly managed borders, customs practices and procedures need to be modernized, including introducing a risk-management regime or green lines for certified traders. At the same time, the lack of formal employment and the breakdown in the rule of law are likely to encourage corruption and bribe-taking by border officials.

Despite difficult borders, post-conflict countries need to reconnect with external markets and the global economy if they are to successfully put conflict to rest. Imports of food, medical supplies, and—later—goods to rebuild need to flow efficiently. In the medium term, goods must be exported to finance reconstruction, pay for imports, and provide livelihoods for the population.

The tension between security concerns and the efficient flow of goods needed for a competitive, growing economy can be managed, but requires high-level host-country ownership of the solution, particularly in post-conflict economies. Following a conflict, not only does the customs administration often have out-of-date procedures and equipment, but corrupt practices have often become solidly entrenched in the organization's culture. These shortcomings undermine both border security and efficient processing of imports and exports. In both areas, improvements require sustained, high-level political attention. This is especially true when the customs administration needs a thorough "house-cleaning" and reform. External technical assistance can only succeed in bringing about change if there is sufficient political support for the needed reforms.

Donor and host-government coordination is likely to pose significant challenges. Beyond the issue of political will and the inherent policy challenges involved in balancing security and commerce, there are likely to be significant donor and host-government coordination issues. Border management is of interest to many domestic agencies and to a number of international organizations and donors. Each may have a different interest, focus, or perspective on post-conflict border management. To provide effective assistance, the priorities of all stakeholders must be managed.

In short, the difficulty of improving border management should not be underestimated; border management must receive appropriate attention early in the post-conflict period.

KEY TRADE-OFFS

Donors assisting post-conflict countries must make decisions quickly, on the basis of specific trade-offs that are much more acute than in stable developing countries. In providing assistance with trade policy and institutions, the key trade-off donors face are *effectiveness vs. efficiency*, *short term vs. long term*, and *urgency vs. legitimacy*.

Effective vs. efficient

Early in the post-conflict period, the host government's capacity to collect import tariffs and excise taxes is usually stronger than its capacity to collect economy-wide sales and income taxes, even though sales taxes, such as VAT (the most efficient type of tax for most developing countries), and income taxes are more efficient. At the same time, it may be possible to reduce the dispersion of tariff rates and eliminate exceptionally high rates on luxury goods, which in practice generate little revenue because of tax avoidance and corruption. Any move toward uniform tariff rates should be encouraged. If an opportunity for such a reform exists, it should be carried out as quickly as possible (as was done in Kosovo, which followed the Chilean model of uniform tariff rates).

Prolonged reliance on tariff revenues or trade taxes to support critical public investment can be self-defeating, because it undermines the development of an efficient, competitive private sector. It may, however, be necessary to impose an interim revenue-generating levy[1] on imports. Such a levy should be applied at a uniform rate across all consumer and capital goods (as was done in Iraq, which introduced a

[1] "Levy" in this usage is meant to refer to any government-imposed charge on imports that is collected across all products (as opposed to product-specific tariffs that can be applied at different rates to different goods).

five percent *ad valorem* to replace tariffs that had been eliminated). (See also Chapter V.A: Fiscal Policy and Institutions.)

Short term vs. long term

Donors should encourage the use of streamlined customs declaration and tax collection systems. These measures can limit corruption and leakage, while simultaneously reducing both public- and private-sector administrative demands and costs. Relying on trade taxes for revenue in the short term means that the customs administration must be improved. Poor administrative capacity within customs and other border management agencies is common in post-conflict countries; it often leads to massive leakage of public revenues, either because importers undervalue their shipments or because customs inspectors are unskilled or corrupt.

Some interventions that may be appropriate in the short term involve a substantial financial cost and should not be continued longer than necessary. Such interventions might include:

- employing a single, internationally recognized firm to conduct pre-shipment inspection (PSI) of imports, in order to verify the value of shipments at their point of origin (introduced early in post-conflict Mozambique and Liberia, for example); and/or
- temporarily replacing local customs-clearance agents and border management officials with expatriate professionals (introduced at a later stage in post-conflict Mozambique and Angola).

These two approaches may be effective as transitional measures, keeping in mind that their substantial financial cost is born by private traders and importers. It should be noted that these approaches are themselves not completely immune from corruption and distortion. In the longer term, these interventions should be eliminated and emphasis should be placed on efforts to broaden the revenue base to reduce reliance on trade taxes.

Urgent vs. legitimate

In the aftermath of a conflict, donors should encourage the host government to take immediate, unilateral actions to liberalize trade policy rather than awaiting multilateral or bilateral negotiations.[2] A number of trade policy measures and institutional decisions need urgent action in post-conflict countries. Donors may, for example, recommend direct management of borders, by hiring expatriate officials or employing a PSI firm. In addition, the opportunity to achieve liberalization may require the host government to quickly develop its trade policy by taking enlightened, unilateral actions (drawn from a short list of proven trade policy measures) rather than working through multilateral or bilateral negotiations.

In the medium term, donors should turn their attention to building the legitimacy of the trade policy process and strengthening implementing institutions. Once urgent procedures and regulations for efficient cross-border trade and simplified revenue collection are in place, host governments should be encouraged to focus on building legitimacy. In some cases, past trade measures were established for sound public health and safety reasons; in other cases, these measures were designed to support rent-seeking behavior by officials in the ministries of health, agriculture, or industry who were protecting the narrow interests of industries in their sector. In either case, establishing a proper policy process for reviewing each measure should be a medium-term priority for the post-conflict government. The host

[2] Often, post-conflict countries already are a party to bilateral, regional, or multilateral trade arrangements, which need to be considered when undertaking any unilateral liberalization efforts. Examples include Haiti's membership in the World Trade Organization and Mozambique's membership in the Southern Africa Development Community.

government and donor community may need to be seen as advocates for the broader interests of the household- and business-consumer sectors, which will benefit from greater openness to imports.

To be effective, international trade negotiations must be perceived as legitimate. Successful negotiations and agreements require a strong capacity to analyze, conduct dialogue, and build consensus. In the short term, post-conflict countries are not likely to have this capacity. In addition, while the direct, immediate removal of trade restrictions generally benefits society at large, it often has an adverse impact on sectors that previously were protected by government trade policies. Representatives of these sectors are likely to challenge the legitimacy of new, more open trade policies, leading to credibility and implementation problems. It will take time to develop the strong public- and private-sector institutions and human resources needed both for negotiations and for dealing with the inevitable challenges to negotiated changes in trade policy. For these reasons, negotiated international trade commitments usually are a longer-term priority in post-conflict countries.

PROGRAMMING OPTIONS

Trade assistance to post-conflict countries should focus on: 1) facilitating trade through effective, secure border management; 2) undertaking unilateral liberalization of trade barriers, balanced by the need for effective short-term revenue collection by customs; and 3) beginning to rebuild trade institutions that can forge a national consensus on open trade and investment policies. With some exceptions, assisting the host government to participate in international trade agreements (particularly bilaterally or as part of multilateral trade negotiations) is a higher priority in stable, developing countries than in post-conflict countries.

Border management: Given the trade-offs discussed above, donor priorities for assisting post-conflict countries with border management include:

- facilitating trade and ensuring security; correcting transport and border infrastructure bottlenecks;
- increasing utilization of risk management and cargo selectivity procedures;
- instituting customs declaration and tariff collection systems that minimize administrative steps while ensuring payment before release of goods (such as using a single administrative document or electronic documents and filing);
- employing a single PSI firm to verify the value of shipments at their point of origin;
- temporarily replacing local customs clearance agents and border management officials with expatriate professionals; and
- training and certifying private customs brokers.

Unilateral liberalization should be considered in the context of a country's bilateral, regional, or multilateral trade commitments. Donor priorities in this area should include:

- simplifying the tariff schedule and implementing the Harmonized System for classifying imports and exports;[3]

[3] The Harmonized Commodity Description and Coding System ("HS") is a multipurpose international product nomenclature developed by the World Customs Organization (WCO). It comprises about 5,000 commodity groups, each identified by a six-digit code, arranged in a legal and logical structure and is supported by well-defined rules to achieve uniform classification. The system is used by more than 190 countries and economies as a basis for their customs tariffs and for the collection of international trade statistics. More than 98 percent of the merchandise in international trade is classified in terms of the HS.

- lowering or eliminating tariffs and other trade barriers; applying a temporary uniform revenue levy rate; and,
- cutting red tape, simplifying licensing, strengthening customs procedures, and controlling corruption.

Rebuilding trade institutions: Donor priorities for assisting with rebuilding trade institutions should include:

- assisting the host government to begin a policy dialogue with the private sector and civil society, with the aim of developing a national consensus for openness to trade and investment; and
- laying the early groundwork for trade institutions that will be able to coordinate policy as needed for participation in international trade negotiations.

TABLE X.1 PRIORITY AND SEQUENCING OF TRADE POLICY AND INSTITUTIONAL ASSISTANCE

Item	*Urgent*	*Immediate*	*Intermediate*	*Consolidating*
Intensive direct border control and management to facilitate trade while maintaining security (including PSI)				
Unilateral trade policy measures (simplifying and lowering tariffs)				
Coordination with private sector and among line trade agencies				
Building nascent trade institutions (consistent with WTO principles and accession process)				
Participation in regional organizations to facilitate trade				
Negotiation of new bilateral agreements or Free Trade Areas				Most effective in stable, developing countries
Participation in WTO negotiations				

	High-intensity level of assistance
	Lower-intensity level of assistance
	Typically very little assistance

Available Rapid Assessment Tools

Assessment assistance is available from USAID's Office of Economic Growth (EGAT/EG) and from a fast-reaction contracting mechanism that provides assistance to facilitate trade, known as Fast Trade. See http://www.tcb-fastrade.com/papers_list.htm.

References for Relevant Case Studies

Gallagher, Mark. September 2007. Building Fiscal Infrastructure in Post-Conflict Societies. Report for USAID prepared by Development Alternatives, Inc.

Lewarne, Stephen and David Snelbecker. December 2004. Economic Governance in War Torn Economies: Lessons Learned from the Marshall Plan to the Reconstruction of Iraq. Report for USAID prepared by The Services Group.

The Integrated Framework for Trade-Related Technical Assistance to least-developed countries (IF) is a multiagency, multi-donor program that assists the least-developed countries to expand their participation in the global economyby enhancing their economic growth and poverty reduction strategies. The IF program was mandated by the WTO Singapore Ministerial Conference in December 1996. The participating agencies are IMF, ITC, UNCTAD, UNDP, World Bank, and the WTO. Integrated Framework diagnostics are available for several post-conflict countries at http://www.integratedframework.org.

XI. INFRASTRUCTURE

> ***Overarching Objective:*** *restore basic infrastructure and infrastructure services that are critical to a resumption of economic activity*

In the aftermath of conflict, donors and the government need to quickly prioritize among the key infrastructure bottlenecks to a resumption of economic activity. The restoration of physical infrastructure and the rebuilding of a country's capacity to manage infrastructure are critical for achieving robust, market-oriented, private-sector-led economic growth. In addition, during the rebuilding process, there often is a substantial need for (and donor support for) reconstruction of infrastructure to improve well-being, such as health clinics, hospitals, schools, and government offices.

POLITICAL AND SOCIAL ISSUES

An infrastructure strategy or activity needs to address a number of political and social issues. Successful approaches for dealing with these issues are well understood today, and the literature on designing effective projects is abundant. Key political and social issues include the following:

Political will is critical. The literature on best practices cites political will and commitment by key leaders to be one of the most important determinants of successful infrastructure reform. Case studies and comparative studies are replete with examples of situations where one or more political leaders were vital to the success of a major infrastructure initiative.[1] There are an equal number of cases where stonewalling or opposition by political leaders caused a reform initiative to fail.[2] The accepted advice given on the matter of political will is to support infrastructure projects that have strong, well-respected advocates at the highest levels of the bureaucracy and political establishment.

Tariff increases are affected by public opposition and ability to pay. It is now well established that large tariff increases are difficult or impossible when incomes have bottomed out due to a conflict and when services are poor. Typically, tariff increases need to be 1) gradual, 2) matched with improvements in services, 3) accompanied by a public relations campaign that explains why tariffs are increasing, and 4) supported by statements from senior politicians about the need for reform. It often is necessary to first stabilize services and rebuild customer relationships, and then to undertake a well-planned series of increases in real tariff rates. This means that the enterprise will need financial subsidies for several transitional years. In practice, the amount by which tariffs can increase depends heavily on a combination of political factors, the rates paid by the public for services obtained through the informal market (for electricity or water), and the level of current tariff rates.

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[1] Examples of individuals playing key leadership roles in successful major infrastructure reforms include Sheela Diksit, Delhi Chief Minister in the Delhi electricity privatization; Dr. William Muhairwe, Managing Director of Uganda National Water & Sewerage Corporation, and Maria Mutagamba, Minister of Water & Environment, in the reform of the Uganda water and sewerage sector; Andranik Andriasyan, Chairman of the Armenian State Committee for Water, in the reform of Armenia's water and sewerage utilities; Mark Dumol, former Chairman of Manila Water & Sewerage Services, in the development of the Manila water concession contracts; and Olu Koker, Managing Director of the Lagos State Water Corporation, in the restructuring of LSWC.

[2] Well-known cases where active opposition from local politicians played a key role in the failure of infrastructure reform efforts are numerous. Interesting examples include the LaPaz/El Alto water concession, and the recently cancelled water management contract for Dar es Salam.

Tariff rates are often politicized. Tariffs are a political issue. It is common for politicians to tell the public that they will be charged very low electricity or water rates. Such politicization of rates is particularly common prior to elections. Tariff rates often need to be depoliticized through multi-donor policy advocacy at the highest levels of government. Another common approach is for reforms to be accompanied by well-funded public relations and customer service initiatives that explain the reform program to citizens, provide information about tariff and cost-recovery issues, and greatly improve responses to customer complaints about billing and service. This approach makes politicization of rates less effective and less attractive to politicians.

Corruption is usually a political issue. Corruption is common in poorly governed utilities. Often, over a period of years, employees and public officials have developed arrangements that take a significant portion of the cash out of a utility through a combination of kickback schemes for contracting, "leakage" in customer collections, and undocumented sale of water or electricity. In a sense, many poorly governed public utilities have been informally privatized by employees and public officials, with the benefit going to these parties rather than to shareholders. Utilities are a major target for corrupt behavior because they generate large amounts of cash through customer revenues and make large payments for supplies, bulk energy, and fixed-asset contracting. Corruption is often enabled by politicians who benefit from the cash taken from a utility. This is not a technical issue; it typically is political, and is directly related to corporate governance arrangements for the utility.

Solutions that typically work include: 1) making new arrangements for corporate governance, which provide a more independent, professionally competent board of directors and management; 2) establishing effective social safety nets and subsidy schemes to ensure a minimum level of supply to the most vulnerable consumers; 3) introducing private-sector participation, with appropriate incentives for the private operator to minimize corruption; and 4) commercializing the utility, accompanied by the introduction of professionalized management, an obligation to balance costs and revenues, and incentives to staff for good performance. It is important to note, however, that it often is essential to provide low-cost supplies of water or electricity to communities of refugees and internally displaced persons (IDPs) for significant periods of time.

***The poor generally can pay*.** Many studies have documented that the poor pay more for informal sector electricity and water than they would if they had a legal service connection and could buy at scheduled tariff rates.[3] Deeply financially troubled utilities typically cannot expand services to extremely poor populations. However, it is remarkable how much the poor actually have been able and willing to pay for water and power when they get reliable, high-quality service, as illustrated by experiences in Afghanistan, Senegal, Tajikistan, and Uganda. In many cases, the poor are willing to pay the actual cost of service; the problem is the willingness of politicians and bureaucrats to charge. Again, this is more of a political problem than a technical one. Solutions include: 1) raising tariffs to levels that allow reasonable cost recovery in slums, to provide an incentive to the utility to expand and maintain services in these areas; 2) using private operating contracts that have explicit targets for services in poor areas; and 3) providing clear incentives (and penalties) to staff and management for service expansion in poor areas. In general, however, if the rates a utility is allowed to charge to the poor are too low, in most situations the utility—whether public or private—will not provide sustained services to the poor.

[3] For example, a World Bank "Willingness to Pay" study in Lagos, Nigeria, found that the poor paid between $1 and $7 per m3 for water from private vendors, while the official tariff rate at that time was $0.50 per m3. Most poor households were unable to obtain legal connections to the network, so they bought their water from private vendors most or all of the time. Another study found that prices in New Delhi in 2003 were $0.025 per m3 for service from public utility connections (not available in many slums), $2 per m3 for water from private tankers, and $12 per m3 when purchased from private vendors in bulk containers. (Llorente, M. and M. Zerah. "The Urban Water Sector: Formal vs. Informal Suppliers in India," *Urban India,* Volume XXII, no. 1.)

Government sovereignty is often the core issue. The government's control over the utility during a rebuilding or transitional period is a major political issue. In some cases, donors want the government to appear to be a sovereign entity in control of basic services, even though the government's capacity to actually run a public utility is extremely weak. The alternative is for donors to convince the government to allow an operating contract to be put in place for a limited period of time, to stabilize the situation, rebuild systems and personnel capacity, and root out corruption. This approach is common in Francophone countries, but less familiar to U.S. assistance programs.[4]

Staff issues are important during the transition period: Utility staffing and salaries can be a very important political and social issue during a rebuilding period. Utilities often have thousands or even tens of thousands of employees. It is common for staff to have low salaries, often below cost-of-living requirements for families. It also is relatively common for poorly paid staff to supplement their incomes with income from other sources, such as tampering with meters or providing unregistered connections. While rebuilding a utility, it generally is necessary to 1) identify and shed highly corrupt staff, 2) reorganize the work force and establish new management and supervisory arrangements, and 3) increase salaries and provide performance-linked incentives. In a number of situations, donors have helped design staff transition arrangements. At times, donors have also funded redundancy programs and training programs.

KEY TRADE-OFFS

Donors assisting post-conflict countries must make decisions quickly, on the basis of specific trade-offs that are not nearly as acute in more stable developing countries. In providing infrastructure assistance, the key trade-offs are *private participation vs. building a public-sector utility*, *rapid vs. gradual investment in physical infrastructure*, *short term vs. long term*, and *effectiveness vs. efficiency*.

Private participation vs. building a public-sector utility

A critical choice for many infrastructure programs in post-conflict countries is whether to try to rebuild local utility companies or to use private-sector participation to re-establish services, customer relationships, and financial and operational viability. Local politicians and bureaucrats often would prefer that a public utility be rebuilt. This may not, however, solve the utility's serious operational and financial problems or lead to acceptable service levels over the medium term. Often, local politicians and bureaucrats would rather keep the utility in public hands. This preference may reflect "good" reasons, such as maintaining sovereignty over public services, building internal management and governance capacity, and preventing a backlash against privatization. It also can reflect "bad" motivations, such as desiring to maintain existing corruption arrangements or prioritizing the interests of public-sector employees over service quality, public financial control, and customer interests.

Best-practice guidance for deciding between private participation and building a public-sector utility includes the following:

- *Determine the level and causes of performance shortfalls.* If performance shortfalls are huge,[5] it often is a sign that serious corruption is present. When corruption is prevalent, it often indicates a

[4] The USAID report "Operating Contracts for Managing Infrastructure Enterprises Under Difficult Conditions" illustrates this concept. The report is cited in the Available Rapid Assessment Tools section at the end of this chapter.

[5] An example of a huge performance deficiency is Lagos State Water Corporation's nonrevenue water (NRW) in 2001, prior to reorganization of the utility. At this time, the World Bank estimated that NRW was 97 percent of total water produced. This means that revenues were collected for only 3 percent of the volume of water produced by the corporation. The rest was lost or stolen.

serious problem with both management and corporate governance. In these conditions, the options often are to replace management and establish new corporate governance arrangements or to use a private operating contract.

- *Remember that operating contracts can be used to stabilize and rebuild the utility.* It is important for donors to be clear in dialogue with the host government that operating contracts, which are used for a limited period of time (two to ten years), are a tool to help rebuild services, operational and financial conditions, customer relationships, and staff capacity. Donors should point out that these arrangements are not permanent, and that they often reflect very positively on government capacity, because of improved staff morale and services.

- *Credible business plans are important.* If the host government requests a large amount of financial support to rebuild infrastructure with public-sector management, the utility needs to have a credible business plan for the rebuilding period. Preparing such a business plan is a relatively inexpensive activity, which can be supported by donors.

Rapid vs. gradual investment in physical infrastructure

Investment in new physical assets should be matched by a well-designed program of institutional strengthening. In post-conflict situations, there is often heavy pressure to make large-scale investments in infrastructure rapidly, before major organizational improvements have occurred. Without institutional strengthening, however, there is a reasonably high probability that new fixed assets will be poorly maintained and that revenues from expanded service will not be realized.

Major physical investments also should be accompanied by appropriately sized investments in the commercial aspects of operating a utility. The utility will not be sustainable if it has large physical asset investments (such as new generating plant investments) but no improvements in its ability to manage customer records and to generate and collect bills.

Short term vs. long term

In post-conflict settings, short-term effectiveness often requires prices to be left at unrealistically low levels. Prices for infrastructure services often are set far too low to cover more than a small fraction of the cost of providing services, and need to be increased to recover more of the cost. At the same time, however, restoring service immediately after a conflict is critical to improving well-being as quickly as possible. Immediate improvements in service often require donor-financed subsidies. In the long-term, prices will have to be raised so that service can be sustained at restored levels. Donors should clearly establish at the outset the expectation that prices will need to be raised for long-term efficiency. Donors also need to build the capacity of the government and infrastructure service providers to manage price-setting.

Effective vs. efficient

A set of infrastructure projects perceived to inordinately benefit only one party or one geographic region may contribute to a return to conflict, no matter how efficient the projects are at increasing well-being and bringing about rapid economic growth. A great deal of infrastructure will need to be rebuilt or repaired following a violent conflict of any significant duration. Even with substantial financial pledges by donors, resources will not be sufficient to rebuild everything at once. Choices must be made among competing projects. One criterion must be the infrastructure projects' contributions to economic growth. This cannot, however, be the sole criterion. The projects' contributions to the well-being of conflict-affected populations must also be considered. The infrastructure projects selected for immediate implementation must benefit all parties to the conflict.

PROGRAMMING OPTIONS

Donors' urgent objective is to work with the post-conflict country to restore basic services. The priority should be to reconstruct infrastructure systems that are vital for the recovery of economic production and the distribution of products and inputs. Donors should support physical infrastructure projects that support economic activity at the productive enterprise level—services that will generate private incomes and employment. Priority projects might include reopening and expediting traffic through main roads, ports, railroads, and airports. Power and water (including the largest user of water, the irrigation subsector) can present a great challenge, because they often have large capital requirements.

Donors and the host government should establish priorities through a joint evaluation process. [6] After a conflict, many major civil works need significant rebuilding and repair. The vetting process used to determine project intervention priorities should include basic economic cost-benefit analysis and a review of the cost-effectiveness of alternative interventions. Donor coordination and program planning is vital, since resources always are insufficient, and rapid but careful assessments are needed before decisions can be made on how to proceed.

In each subsector, donors should strike a balance between physical reconstruction and rebuilding the institutions that manage and maintain infrastructure. Depending upon the duration, extent, and severity of the conflict, a post-conflict country is likely to need to undergo a significant phase of reconstructing damaged or destroyed physical infrastructure. During this phase, if there was an exodus of managerial and technical professionals during the conflict, the public institutions that manage and maintain critical infrastructure may also need to be rebuilt. Technical assistance and training are likely to be needed to re-establish basic administrative and management capacities.

Successful infrastructure development typically requires a two-pronged approach, with an emphasis on:

1) *restoring core infrastructure and services.* Donors should
    - promote inclusive sector strategies, working with host-country officials;
    - lower costs and increase access by using basic design standards;
    - rely on local labor and entrepreneurs whenever possible; and
    - plan for and include operations and maintence in restoration plans.

2) *building institutional operating capacity for governance and management.* Donors should:
    - provide basic training and technical assistance;
    - work within the national budget process; and
    - use operating contracts during the transition periods.

Institutional capacity-building is particularly important—without it, restored physical infrastructure is not likely to be sustained. Donors must help build the capacity of the institutions that operate, manage, or regulate infrastructure. For these institutions to achieve and maintain sustainable operations over the long term, they need both strong external discipline over operations and improved internal technical, management, and administrative capacity.

[6] Local ownership in the projects can encourage the host government to become operational more quickly, although this may in practice require many years. Operating contracts should be used in the initial recovery phase.

In most post-conflict countries, local management and administrative capacity is weak. Often, it is nonexistent or nonfunctional. Re-establishing critical infrastructure without a basic level of supervisory management and administrative competence, as well as basic regulation, can cause immediate operational and management problems. These problems are difficult to remedy once they take root. Corruption, in particular, can rapidly grow in a utility, sapping the entrepreneurial spirit needed for economic recovery and rendering donor programs ineffective.

It takes many years to rebuild local management and operating capacity in many post-conflict countries. The long time frame often exceeds donors' funding horizons and may strain their funding capacities. In these difficult situations, donors may wish to advocate the use of operating contracts as the most rapid way to re-establish utility services.

State-owned enterprises (SOEs) in the infrastructure sector often have particularly weak capacity, especially under legacy political systems. After a conflict, the re-establishment of state-owned or managed infrastructure companies has often resulted in suboptimal service, continued bad governance, insufficient investment in facilities, and unsustainable operations.[7] One typical problem at SOEs in infrastructure subsectors is that "customer-facing" functions are neglected: meters are not read, bills are not collected, customer requests for new service are not fulfilled.

Early in the post-conflict period (generally the first 18 months), there is a window of opportunity to undertake critical reforms in the water, power, transport, and telecommunications subsectors. Donors should carry out a diagnostic of conditions in priority infrastructure subsectors. They should examine the need for and opportunities to implement systemic reforms as part of the restoration program. In some countries, it is possible to carry out the types of reforms that are critical to the subsector's long-term development, such as restructuring the water and power sectors, unbundling electricity utilities into separate divisions or companies, and establishing regulatory agencies. Donors and host governments need to consider the nature of the conflict when deciding whether there should be a national system, a system made up of regional semi-autonomous entities, or a more decentralized system.

Depending on specific country circumstances, immediate priorities for emergency repairs to damaged infrastructure and for the restoration of basic services should be:

- *electricity generation, transmission, and distribution*—to supply basic, essential service to the country's main centers of non-agricultural production and employment; and
- *transportation networks*—to facilitate agricultural production and marketing, and other flows of goods and services through business supply chains.[8]

Donor assistance should generally involve helping utility organizations overcome critical institutional development challenges, such as training staff and developing effective financial, personnel, and technical management systems. Management contracts can help build capacity and are reasonably inexpensive.

Transportation is often an obvious candidate for priority attention from donors. Reducing barriers to the use of transport facilities is sometimes even more important than physically reconstructing transportation infrastructure. Police, militias, and customs agents often establish widespread internal checkpoints where goods are stopped and taxed. These practices, which amount to quasi-official banditry, are significant barriers to regional and international trade in some countries. Targeted assistance

[7] The poorly performing and financial distressed state-owned electricity company in Kosovo, more than seven years after the end of open conflict, provides an example of such dysfunctional state management.

[8] Roads often are an immediate priority in post-conflict countries (e.g., Afghanistan), but sometimes immediate attention to ports and airports is a higher priority (e.g., Liberia) because of their importance to ensuring reliability, maintaining security, and reducing costs in international trade.

and training from donors can help reduce these barriers.[9] Rebuilding transportation networks poses the same challenge faced throughout the infrastructure sector: high capital requirements, which result in the need to attract private participation.

Outsourcing the management of critical transportation nodes and functions can have a tremendous impact on economic growth. Extensive corruption and mismanagement at ports, airports, and municipal markets, for example, can have a huge effect on prices and on the private sector's ability to trade. Often, donors do not consider private operating arrangements for critical nodes. They may be reluctant to confront an inept public-sector bureaucracy, or they may not fully recognize the impact key transit points can have on private-sector incomes. In many cases, private operating arrangements in the transportation subsector have enhanced economic growth. Examples include rail privatization in Mozambique, port privatization in Argentina, the privatization of customs functions in Indonesia, and the establishment of operating contracts for cold cargo facilities in India and Chile. In addition to economic benefits, the social implications of freeing up these "chokepoints" can be huge.

Private investors can play an important role in the provision of some infrastructure services. At one extreme, since the advent of cheap mobile phones and satellite communications technology, the private sector may quickly and completely provide telecommunications services, with no investment and minimal enabling support by the public sector.[10] For other utilities and infrastructure, a hybrid public-private relationship, such as a management contract or private concession to operate a facility or network, may be necessary. High capital requirements for restoring many infrastructure services can be problematic for donors. In many cases, private investors, operators, and other sources of finance must be brought in. To attract these private partners, host governments must offer reasonable commercial terms and conditions, as well as incentives to invest and operate.

TABLE XI.1

Private Participation Continuum: Public to Private

PUBLIC	--**TA and/or outsourcing contracts for certain aspects such as bill collecting**	**Management contracts**	**Leases**	**Concessions**	PRIVATE
	May work if there is full **cooperation from managers**	Introduce discipline; **private firm runs company**; similar to receivership	Private firm operates & maintains; **investment funded by public sector**	Private firm operates & maintains; **investment by private firm**	

It generally is unrealistic to expect the private sector to undertake major infrastructure investments, due to the high risks of most post-conflict environments (specifically, the possible return to conflict and the unpredictable regulatory environment). A multi-year concession is often the best alternative to privatization for an existing utility provider that needs major investment. There is also a continuum of shorter-term options for contracting out the utility's management or aspects of its operations (particularly for its key customer-facing functions), as shown in Table XI-1 to the left.

As arrangements move closer toward the private-ownership end of the continuum, it becomes increasingly important for the public regulator to accept market-based pricing for the company's services and to allow enforcement (through service cutoffs) of customer collections.

[9] Recent examples show the importance of combining staff training with performance-related incentives to improve customer service and operational performance in power, water, and sanitation utilities. See (for example) the Uganda National Water & Sewerage Corporation case.
[10] Such enabling support may include new legislation and a regulation to permit private investment in mobile telephony, such as the enabling support provided by USAID Afghanistan.

USAID now supports early interventions that establish operating contracts. These are management contracts or leases, with private-sector operating companies undertaking the work. These companies, which often are foreign businesses operating independently or as joint ventures with regional companies, have experienced management and staff and are able to re-establish basic services and operate critical utilities when local capacity is weak. Donors can provide valuable support by helping define an appropriate scope for such contracts, assisting with the pre-qualification of bidders (to exclude inexperienced but politically connected bidders), and ensuring that there will be adequate competition and integrity in the procurement process. USAID has supported operating contracts in Georgia, Jordan, Liberia, and Kosovo. This approach also has been used successfully in difficult environments, such as Cambodia, Cote d'Ivoire, and Tajikistan.

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