

## **Urgency and Legitimacy: Tensions in Rebuilding the Legal Structure for Business in Post-Conflict Countries**

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One of the well documented casualties of conflict is the economy. Civil strife – whether war, riots, or even a bloodless coup d'état – inevitably disrupts business activity, sometimes reversing years of steady growth as markets come apart and business interests either flee or reduce their activities.

In impoverished countries, of course, the impact is even greater. Because of this impact, reformers in post-conflict societies will often put high priority on rebuilding the commercial sector. Economic growth has been shown to have a stabilizing impact. In his book, *The Moral Consequences of Economic Growth*, Benjamin Friedman catalogues a wide range of positive socio-economic improvements in countries when they are growing economically, including greater acceptance of religious and ethnic differences that are often used as excuses for conflict in a shrinking economy. It is also well accepted that growth creates jobs, and jobs are needed to engage potential combatants in productive activity.

The cessation of conflict establishes possibilities for rebuilding conflict-ravaged economies. Donor organizations often rush to help re-establish the framework for doing business, from rebuilding roads and marketplaces to revising laws and regulations. This work is often done on an urgent basis to redirect activity into productive endeavors and growth, with the hope of forestalling and permanently avoiding a reversion to disarray.

### **Conditions for Investment**

It is well known that investors – whether domestic or foreign, large or small – require certain preconditions before they will initiate or increase their exposure in a market.<sup>2</sup> First, they require a certain degree of stability in the operating environment. Second, they need mid-range or long-range predictability of basic conditions and dynamics within the market. Third, they want some degree of transparency and certainty so that the rules of the game are known, and the application of the rules is trustworthy.

All of these factors affect the costs and risks of doing business. To succeed, business must balance the costs and risks against revenue potential. In a competitive environment, business cannot simply cushion the impact of costs and risks by raising prices, because

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<sup>2</sup> While it is possible for a few businesses to operate very profitably during periods of conflict – whether legally or illegally – these individual successes militate against broad-based growth. Indeed, International Alert notes that businesses which prosper from conflict often deliberately prolong conflict for their benefit. See their publication, *Local Business, Local Peace: The Peacebuilding Potential of the Domestic Private Sector*, Banfield, Gündüz and Killick, (editors), 2006. Moreover, those who prosper during conflict often obtain entrenched positions and thereafter use their power to undermine competition. The focus of this article – and donor work – is on creating an environment conducive to broad-based, competitive growth.

competitors can then underbid them. Instead, they must manage the risks and lower the costs.

Post-conflict societies are inherently high risk and high cost business environments. Creating stability, predictability, transparency, and certainty are vital in improving the overall enabling environment to provide enough protection for investors to initiate or increase commercial activity. The existing disarray as a country moves out of conflict mandates urgent intervention to get the economy back on the hard road to recovery.

### **The Problem of Urgency**

The physical framework of a post-conflict country provides a ready roadmap of needs. It is relatively easy to identify the destruction of bridges, buildings, marketplaces, dams and roadways, and to perform cost/benefit analyses for priority interventions to rebuild the infrastructure. Donor nations and organizations can often arrange assistance for these projects on an immediate basis once sufficient stability is restored.

Needs in the legal framework are less obvious. Most post-conflict countries started with a legal and regulatory system that did not provide for broad-based economic growth. East Timor, Afghanistan, DRC Congo, Guinea-Bissau, Angola, and so many other countries at the top of the misery index were under-developed well before their conflicts began. Their legal systems did not support growth or development, a factor that can be seen as well in the World Bank's *Doing Business* reports on regulatory burdens. Developing and transition countries are all too frequently characterized by unbearable burdens of regulation that depress business and force much of the economy into the less productive informal sector.

As with physical infrastructure, it is possible to approach business environment reform using an urgent timetable. Post-conflict conditions often include a weak parliament, little capacity to examine and delay legislation or decrees, and an executive in need of donor support. The basic elements of a commercial legal framework are known. European and international best practices have been effectively established for a wide range of commercial issues, from banking to secured transactions to enforcement of commercial obligations. It is therefore tempting to adopt such recognized models on an urgent basis in order to kick-start the economy back into growth mode.

But urgent lawmaking is not the same as urgent building projects. Rehabilitating the electrical grid involves mechanics – a static system with known and identifiable solutions that can be applied without regard to culture or history. Distribution of electricity may bring political processes into play as decisions are made on which parts of the grid to rehabilitate first, but for the most part, such work is not inherently political.

Lawmaking and regulation are unavoidably political. Normally, laws derive from the surrounding culture and power dynamics, with strong historical underpinnings as well. Unlike an machine in which parts can simply be exchanged, the legal system is dynamic, much more akin to a human body in which parts *cannot* simply be exchanged because of

the complexity of factors involved in the transplant. Urgency is sometimes required, but it must be accompanied by long-term program of support to ensure that the transplant functions.

The primary victim of urgent lawmaking is legitimacy. Effective policy reform (which leads to legal and regulatory reform) takes time in order to negotiate the human dynamics of the reforms under consideration. Laws regulate one thing and one thing only: human relationships. When restructured without sufficient regard to relationships – which are inevitably restructured during the reforms – laws will be ineffective at best or damaging at worst.

The reason that urgent laws are too often illegitimate is that they too often violate one or more of the three tenets of legitimacy: process, substance, and representation. **Process** is legitimate when the system for identifying, analyzing, reforming and producing legislative change is acceptable to the stakeholders who are affected by it. They may not like the outcome, but they accept that the reforms were done in the right way. Authoritarian regimes often must rely on force to impose policy changes, because the system of change does not permit sufficient participation by stakeholders to establish consensus or ownership.

**Substance** is legitimate only when the content of the reforms meets the stated needs and objectives that gave rise to the reforms. It is possible to follow prescribed legislative procedures and still end up with a law that fails to meet its objectives. In Croatia, a company law was promulgated in accordance with normal procedures (which did not include input from the business community) in the late 1990s, which was deeply flawed and had to be amended immediately.

**Representation** is legitimate when those responsible for making the change are accepted by the stakeholders as appropriate. When an unpopular leader imposes new requirements on business, the community may reject the changes based on perceived illegitimacy of the leadership. In many post-conflict situations, the extensive use of foreign consultants to draft laws can lead to rejection of the laws as non-representative even if the substance is excellent and the process used was fully in line with legal requirements.

The time constraints of urgent reform often serve to undermine the processes needed to ensure legitimacy. In OECD countries, laws are generally passed only after extensive, time-consuming analysis, discussion, public participation, and refinement. Even a relatively simple legislative amendment can take years to get from proposal to passage. On average, most laws take at least 2-5 years *after the first draft is prepared*, with major reforms sometimes taking more than 10 years in normal circumstances.

Even in transition settings, with incentives such as a bilateral trade agreement or WTO accession in the background, legislative drafting programs have typically been given at least 3-5 years to prepare texts, identify stakeholder groups and educate government about both the need for reform and the most desirable models before presenting drafts for

ratification by the legislature. This approach has been used Vietnam with spectacular success.

But post-conflict societies are not normal. Changes are needed immediately and little time is given for the slow, deliberative processes that engage relevant stakeholders effectively in the preparation and adoption of policies. Priorities are often set by political pressures imposed by outsiders to the country. International accords in Bosnia and Afghanistan set aggressive timetables for adoption of various laws and policies.

Analysis of lawmaking over the past decade or more suggests that urgent laws have a high rate of failure. That is, despite passage, they are seldom implemented by the stakeholders who were expected to embrace the changes and march forward. Frequently, legal professionals describe their country as having many good laws that no one uses. This raises a rather fundamental question: if a law is not ever used, is it really any good?

On the other hand, some urgent laws have been effective. The banking law in Afghanistan was passed hurriedly and in English (not an official language), violating a number of tenets of process legitimacy, yet presaged significant investment in the banking industry, investment that would not have been made without the law. Likewise, customs regulations were adopted on an urgent basis in order to establish a system of controls on exports and imports; the regulations are used by customs agents, despite any deep efforts at ensuring legitimacy.

There is a tension in effectiveness versus urgency. Most urgent laws are ineffective – because they are perceived to be illegitimate. Some are accepted and have substantial positive impact. When can urgency be employed effectively, and what is the role of business in post-conflict reconstruction?

### **Ensuring Legitimacy: The Role of Business in Post-Conflict Reforms**

The number one impediment to effective business legislation in post-conflict countries is the failure of drafters to include business in a meaningful way. There is a tendency to believe that replicating standards from another country where business and investment are vibrant will achieve the same vibrancy locally. We know for a fact that the solutions are not that simple. Croatia tried that approach by adopting a German company law without input from the business community, until *after* adoption, when it became clear that the law would not work in Croatia. Commercial law development that does not include the intended business beneficiaries is per se illegitimate.

Business must be included in commercial policy reform. This starts with process that permits a meaningful opportunity for analysis and input. When commercial actors are left out of the process, they can and often will “veto” reforms by simply refusing to comply with or implement the laws.

Business input must be substantive. In post conflict settings, this will often require assistance, as the human resource capacity of the business community is often

diminished. Technical assistance in understanding, interpreting, and commenting upon drafts can give business a voice in the process that will help to create consensus.

Finally, legitimacy demands that business perceives that commercial interests are appropriately represented in the process. This may be through the use of various business associations as a conduit for review of policies, through a process in place that ensures a business voice so that they feel they have been heard, or through the presence of a business “champion” in government who pursues commercial reforms on behalf of the business community.

Unfortunately, these features are often missing in post-conflict societies. Indeed, they were also frequently missing before the conflicts began. Therefore, the first role of business is to gain a place at the table.

Establishing a Voice for Business. In a country that has never had a process for reaching out to business for input into policy, there may be a great deal of resistance, or at least inertia, as the business community seeks to establish itself. Frequently, ideological legacies continue to confuse commercial interests with exploitation, banking with parasitic extraction, and profits with theft. Overcoming such views will require education and time, but they should be viewed as an inconvenience, not an absolute bar to change.

To have a voice, business must organize itself into organizations that can speak on behalf of the membership. When Guinea-Bissau attempted to rebuild in the mid 1990s during openings in a post-independence totalitarian regime, little was achieved until various interest groups – producers, importers, women entrepreneurs, exporters – were able to organize and speak with the voice of hundreds of thousands of voters behind them. With such a voice, government could no longer ignore their requests, but instead made changes.

Unfortunately, some governments do not listen effectively to local investors. A misunderstanding of the importance of foreign investment can lead to situations in which local decision-makers give priority to the expressed needs of foreign investors. In former Yugoslavia, various bi-lateral organizations, such as the American Chamber of Commerce (AmCham), have provided a means for domestic and foreign investors to speak together with one voice on general issues affecting the business community. Frequently, AmChams will associate with other local and international chambers for even greater voice and participation.

But the chaos of conflict can slow the formation of effective representative organizations. In those situations, business can still voice its concerns, but less directly. Foreign investors have an advantage of diplomatic representation which they can use by making their needs known to commercial attachés, ambassadors, and even USAID missions. Domestic investors can also appeal to foreign representatives to assist in pursuing a business-friendly reform agenda.

By having a voice in the reform process, business and its advocates can help to establish procedural and representational legitimacy.

Using the Voice of Business. It is not enough to have a voice: the business community must know what to say. While this is true in any setting, in the urgency of post-conflict reconstruction, the importance of the right agenda is even greater.

One of the principle reasons that urgent policy reforms fail to produce their intended results, is that those driving the reforms fail to understand or ascertain the priority needs of the commercial actors in the country. Regrettably, a preponderance of reform efforts are based on supply-side interventions arising from generic, theoretical understanding of how to construct a healthy commercial framework. While the reformers are generally correct that competitive business environments have solid laws on company formation and bankruptcy procedures, such policies are seldom urgent. In Afghanistan today, banks are investing without a sufficient bankruptcy regime, and businesses have been investing without a modern company law. Why? Because these laws are not priorities for investors.

The Afghan International Chamber of Commerce (AICC) understands the potential power of its voice (in part because its members have broad international experience). AICC has put together a reform agenda that sets the actual needs of actual investors, ranging from provision of electricity to secure land rights to reduction in corruption and business regulation. Their message is simple: make these reforms and investment will increase.

The urgent reform agenda, which resulted in use of emergency executive decrees in January to by-pass the slow-moving legislature and adopt ten commercial laws, does not track the needs of investors adequately. One of the “urgent” reforms was a company law, which investors were not asking for. Because many of these laws do not respond to the needs of local and foreign investors, and because they were passed using a questionable approach, few find the laws to be legitimate. This is not surprising – even if the laws were the right ones to pass at this time, without a shared understanding among commercial stakeholders and the reformers, there is no basis for ownership, consensus or implementation.

By contrast, the banking law was accepted, despite its manifest breach of procedural legitimacy. The banking law was based on the identified needs of banking investors who would not invest without certain changes being made, but who were prepared to invest if the changes came about. In other words, there was inherent demand for increased banking activity, by both borrowers and lenders, but there was an identifiable barrier to increased investment. Once the barrier was removed, investors acted.

The business community knows better than any other group what constraints are standing in the way of business. It is essential for them to identify the barriers, present them to reformers, and advocate for the changes they need. It is just as important for the business community to make recommendations on what reforms should *not* be pursued in the short

term. With limited resources, post-conflict reformers can ill afford to spend them on non-priority initiatives.

### **Rebuilding Relationships: A Goal of Business Advocacy**

It is interesting to note that the recent analysis of business and post-conflict reconstruction by International Alert, *Local Business, Local Peace: The Peacebuilding Potential of the Domestic Private Sector* (Banfield, Gündüz and Killick, (editors), 2006), provides a wide variety of cases studies with a common theme: rebuilding relationships. Conflict can further fray the social fabric of communication and relationship that are needed for healthy economic and democratic activity. As discussed above, most post-conflict countries (and most developing countries as well), have policy reform mechanisms that fail to engage stakeholders in decisions that will affect them.

Business is a vital link in the feedback loop that leads to effect policy development and reform. Commercial actors are best placed to understand the existing environment and the practical implications of reform initiatives. By working together with government and other interest groups, business can play an active role in creating the consensus necessary for effective policy implementation. Without consensus, there is no basis for implementation. Without rebuilding relationships, there is no basis for consensus.

Government should engage business in the policy process, but it may not do so. Many countries still lack a mandatory system of public notice and participation in legislative and regulatory reform. In such situations, business must engage government, maintaining persistent but respectful pressure until there is formal change in the system.

Business should also be prepared to provide solutions for itself, such as self-regulation and self-organization. Government cannot do everything, nor should it. In post-conflict societies, the capacity of government to regulate economic behavior, enforce contracts or promote business interests at home or abroad is heavily circumscribed.

There is much that business can do on its own to promote a better business environment, from establishing private credit information bureaus, to building certification systems, to organizing professional and trade associations. These do not require government interventions.

Business can also engage government productively outside of the arena of legal reform. Many barriers to a healthy business environment are a result of poorly applied regulations. These barriers require improved behavior, not improved laws. In Bosnia, when the courts were unable to seize property effectively due to limited resources, the banking association initiated a partnership to provide an auction center for the courts to use in order to overcome resource deficiencies that halted proper application of existin law. In numerous other settings, business associations have provided input to government on practical problems and solutions that could be achieved without need for legal reforms.

By actively building relationships with government, business overcomes legitimacy shortcomings inherent in an authoritarian or non-participatory system. At the same time, business reduces the risk of unexpected changes by participating in the change mechanisms, thus providing greater stability to the enabling environment.

### **Final Thoughts: Practical Priorities for Business in Post-Conflict Reforms**

Urgent reforms run the risk of short-circuiting the process, substance, and representation requirements of legitimate reform. Sometimes these sub-optimal results are justified by the need for immediate action, but it is just as likely that immediate action may not be justified for the specific reforms.

Business can and must play an active role in defining and prioritizing reforms. This can be done through a number of practical means:

1. Establish Associations. Businesses have very little effective voice unless they are organized to provide a common front. The power of organizations who actively represent thousands of economic actors and millions of dollars in commerce (and thus substantial tax revenues) is much greater than a few lone enterprises trying to produce change.
2. Set the Reform Agenda. Government can only guess at the true immediate needs of the business community. It is the responsibility of business to identify priorities and advocate the timetable. If reforms are urgent, the urgency should be defined by the immediate impact on economic activity and investment. Otherwise, a more methodical, deliberate approach should be employed to ensure consensus, ownership and legitimacy. In either case, one of the most important framework laws for the protection of business and civil society interests is a on legislative and regulatory procedure that mandates participatory process and defines the parameters for urgent or emergency legislation. Otherwise, all legislation may be given emergency treatment, to the detriment of the economic climate.
3. Monitor the Results. Reforms are frequently treated as one-off, one-time changes in law and regulation that will last indefinitely. Instead, all laws eventually need refinement, and laws passed in a hurry will need to be amended even sooner. Business can and must find ways, together with the legal profession and other interest groups, of identifying problems and recommending amendments. In some cases, amendment of existing law can have far greater positive impact than creation of new laws, but only if someone is actively analyzing such impact.
4. Educate the Community. Laws are frequently passed with little or no public education on their impact or application. In such cases, they often “remain on the page” instead of stimulating economic behavior. Business associations are crucial for educating and informing both members and the general public about legal reform and its implications.
5. Work with Other Advocates. Policymaking and legal reform are inherently political. Foreign donors are a source of substantial political leverage if engaged in business-supportive advocacy. Local and foreign investors should seek to



formally present their reform agenda to embassies, donor missions, international organizations and funding agencies so that they are aware of the demand-side priorities for the business climate.

Business is the engine of economic growth and an invaluable source of socio-economic stability. Business also has the resources and understanding to confront many of the problems facing post-conflict countries by rebuilding relationships between government and governed, setting reform priorities, and actively monitoring results. Investments in these areas will not only pay off in the short term, but will also lay the foundations for long-term growth.