

CHAPTER 4

Economic policies for post-conflict reconstruction and development

In its broad sense, reconstruction refers to the rebuilding of structures, institutions, and conditions that prevailed during peacetime. Reconstruction also encompasses the rehabilitation of basic services like health and education. The key questions facing countries undertaking a post-conflict reconstruction program include what to reconstruct and how to reconstruct. These questions are important because not all peacetime conditions are desirable, and reconstructing undesirable conditions may therefore constitute a recipe for future conflict. Peacebuilding is a form of reconstruction, peace being the object of reconstruction. This Report has already dealt with aspects of reconstruction relating to peace building in Chapter 3. This chapter focuses on economic policies for reconstruction and development.

Economic policies are vitally important, not only for progress towards prosperity, but also for the more fundamental challenge of maintaining peace. There are three reasons why economic policy should be accorded priority status. First, the urgent need to reduce poverty in post-conflict environments: prolonged conflict occurs disproportionately in societies that are already poor, and poverty typically deepens during conflict. Pitifully low living standards are thus a legacy of prolonged conflict. Moreover, during prolonged conflict people are driven to adopt desperate strategies for

economic survival. They may have been driven by fear of violence into locations and activities that provide only precarious and possibly unsustainable incomes. Hence, there is an urgent need to improve living standards, which can only be achieved by raising incomes. Second, low income is a risk factor for violent conflict. Thus, economic recovery should help reduce the risk of reversion to conflict. Third, economic outcomes during post-conflict periods are far more variable than in other situations. On average, post-conflict economies grow more rapidly than normal as they bounce back from the damage done during conflict, but the range of performance is very wide. It is quite possible to sustain growth rates of 10 percent or more for an entire decade, as was the case in Mozambique. However, some post-conflict societies do not experience rapid recovery: for example, Zimbabwe's per capita income stagnated during the 1980s, its post-conflict decade. The variability of post-conflict economic outcomes suggests that performance during this period is particularly sensitive to policy choices.

The first section of this chapter outlines the distinctive context of economic policy after civil conflict. The next section proposes, from a government standpoint, a set of policies for economic recovery during the post-conflict decade. The third considers the same issues from the standpoint of

donors; while the fourth broadens the analysis to other forms of conflict beyond civil war: international conflicts and tensions, as well as internal violence that does not scale up to civil war.

The distinctive context of post-conflict situations

The economic consequences of conflict include capital flight, poor policy, economic decline, damaged infrastructure, increased military spending, structural changes to the economy, and shortened time horizon for government and private agents. Post-conflict economic recovery is fundamentally dependent on responses by the private sector. Capital flight that occurs during conflict may continue or be reversed post-war. Since the stock of assets held abroad is often very large relative to the economy, this difference is critical to economic recovery. Capital flight may continue because the process of shifting assets abroad during the conflict had not been completed, or because new wealth, generated by high profits in the post-conflict environment, is being shifted abroad owing to concerns about further insecurity. Davies (2008a) finds that capital flight usually continues during the post-conflict period. However, there are exceptions: Uganda succeeded in attracting substantial human and financial capital repatriation during its first post-conflict decade. Such repatriation helps finance private sector recovery.

Recovery also affects the structure of the economy. Sectors that contracted during the conflict expand: for example, rural economies see a return to the market. However, this process creates the possibility

of bottlenecks as the output of some sectors is needed for the expansion of others. The most likely bottleneck is the supply of non-tradable capital goods.

The legacy of a diminished construction sector, with few firms and depleted skills, slows the pace of recovery. It also gives rise to booms in construction prices as sharply increased demand meets severely curtailed supply. For example, in Liberia the cost of building a school has doubled. These price booms have two detrimental effects. They dissipate increased spending in higher costs, and they also generate large 'rents' for those who control supply, opening up the possibility of political corruption.

There may also be other bottleneck goods or services. In construction, cement is one of the key inputs that become quasi-non-tradable if the country is landlocked. For example, in Southern Sudan the cost of importing cement from the world market is prohibitive and cement has to be brought overland from Uganda, which itself has limited supply. Similarly, there may be bottlenecks in specialized professions. Paddy Ashdown, the former Commissioner for Bosnia, wrote that what he really needed to assist the Bosnian recovery was 'accountants without borders'. In Sierra Leone there has been a shortage of specialist lawyers.

Post-conflict economic policies

In many respects, the challenges posed to economic policies in post-conflict societies are similar to those posed by societies that have been at peace, but in which policies and governance are poor and incomes are low. In other respects, however, there are

distinctive differences. Since there is already an enormous literature on economic reform in peaceful societies, the pertinent issue is why policies differ if the society is just emerging from prolonged conflict. One of the reasons is that objectives are markedly different in post-conflict settings relative to peace settings. This section elaborates on these differences.

Distinctive objectives

Post-conflict societies face a heightened risk of conflict reversion. Governments will therefore rightly be concerned, not only with economic recovery as an end in itself, but with adopting economic policies that help reduce the risk of conflict. Of course, governments in all societies wish to minimize the risk of civil war; however, this objective should receive a considerably higher priority in post-conflict societies because the risk is much higher. There is a potential trade-off between policies that promote growth and those that promote peace. For example, policies focused on growth may concentrate spending on regions with a higher growth potential; however, this may aggravate regional inequality. Where such trade-offs exist, peace building policies would naturally take priority, as economic growth or recovery would be threatened in the absence of peace. However, the objective of risk reduction does not always conflict with that of economic recovery. On the contrary, economic recovery could help bring risks down in the long term. The premium on risk reduction does change appropriate economic priorities in two key respects.

One of the distinctive policies is the appropriate level of military spending. The

usual response by governments to the high risk of conflict reversion is to maintain military spending at a high level. While this is understandable, it reduces the funds available for directly productive public spending. In a post-conflict context, public spending needs are particularly acute, while revenue sources are particularly modest. Consequently, the release of money from the military budget would be highly valuable. Moreover, since one of the legacies of conflict is an inflated military budget, there is an unusually large scope for reduced spending. For example, Mozambique undertook deep cuts in its military budget at the end of its civil conflict.

Although high military expenditure reduces funds for productive spending, it may be the price for peace, at least in the short term. Notably, if a peace agreement calls for the absorption of former rebel combatants into the military, large cuts in military expenditures may threaten the fragile peace. Given this caveat, opportunities for reducing military spending should be seized whenever such cuts do not compromise peace and security.

Economic priorities are also likely to be distinctive in the creation of jobs for young men: the higher the proportion of males aged 15–29, the higher the risk of conflict. This is unsurprising since this is the group that forms the recruitment base for rebel armies. The extremely high costs of conflict reversion suggest that it is worth spending public money to create jobs for this segment of the workforce. Indeed, this may be part of the rationale for high post-conflict military spending: By maintaining a large army, the government keeps young men contained.

Different types of public spending have very different intensities of employment of young males. This implies that the true costs of different types of public spending may diverge considerably from their monetary costs.

Distinctive policies for economic growth

This section considers how economic growth policies may need to be distinctive.

The pace of economic policy reform

As noted earlier, one of the legacies of civil war is an accumulation of poor economic policies that have snatched short-term benefits at the price of long-term damage. This implies the need for rapid reform.

Policies in post-conflict countries are atypically poor, making a strong case for accelerated reform. In addition, the political costs of reform are expected to be lower than usual for two reasons: First, the vested interests that usually block reform are likely to have been weakened by the conflict. Second, with the onset of peace, people expect change: Peace may provide a unique window for coordinated reforms in which groups are willing to tolerate some loss of special interests because they are confident that they will benefit from many other reforms. The success of reform often depends upon such a coordination of expectations. Economic reform is usually quite rapid in post-conflict contexts. Whereas the average Country Policy and Institutional Assessment (CPIA) at the onset of peace is only 2.41, by the end of the decade, it is around 3.05, slightly higher than the CPIA for the average low-income country at peace. However, these

improvements are achieved despite the low priority accorded to economic policies — they do not receive much political attention in the early post-conflict years. There are strong pressures to divert attention from the positive sum game of economic reform to the zero sum game of distribution of political power among groups. Rwanda is an exception to this relative neglect. The post-conflict government prioritized economic reform and has achieved remarkably rapid economic growth despite the severe handicap of being landlocked and resource-scarce.

Macroeconomic policy

One of the legacies of prolonged civil war is a high rate of inflation. Post-conflict governments face hard choices in confronting inflation. One of these choices is to adopt a contractionary fiscal policy with a combination of additional taxation and reduced spending. However, this policy stance entails substantial trade-offs. The social returns on public spending are particularly high, implying that inflation reduction by means of reduced public spending is costly. Furthermore, the social cost of additional taxation may also be atypically high, meaning that reduced inflation by means of increased taxation would be costly.

Taxation may be particularly costly in post-conflict situations because during prolonged conflict most economic activity would have retreated into informality, resulting in a smaller tax base. One of the priorities for post-conflict recovery should be the reversal of this process to accelerate the return to a formal economy. Formaliza-

tion has various advantages: It permits greater economies of scale; it makes transactions with other firms more readily enforceable; and it facilitates future taxation. Thus, even from the narrow perspective of public revenues, there is a good case for the government giving priority to building the taxable base of the economy — and hence future revenues —, rather than seeking to maximize revenues in the short term. Indeed, the economic rationale for building future revenues by moderating current taxation is analogous to the case for building future seigniorage revenues by moderating current inflation.

The need for tax moderation is reinforced by the legacy of a decayed public administration and the rise of private opportunism. Firms cannot be trusted to report accurate accounts to tax collectors, and tax collectors cannot be trusted to behave honestly. In combination, these behaviours produce low-revenue yields from taxes and high corruption costs. The problem of poorly motivated tax collectors is sometimes resolved by explicit revenue targets and by preventing face-to-face negotiations between individual tax collectors and firms. However, in the post-conflict context, the accounts of firms cannot often be trusted. In practice, the tax payments deemed reasonable by collectors are likely to be influenced by the visible prosperity of the firm, but, since investment is the most important such sign, this behaviour approximates to an investment tax. Since governments wish to encourage private investment, this inadvertent effect of the tax effort undermines their post-conflict recovery agendas.

Reversing the flight of capital and skills

Post-conflict societies are extremely short of both human capital and private investment because of capital flight. However, their previous flight constitutes an opportunity: at its best, flight during conflict preserves both skilled people and assets. The challenge is thus to repatriate them.

The repatriation of capital is induced by improvements in domestic economic conditions, including a decline in inflation. However, much more can be done. Members of the diaspora may be willing to return with their skills and their capital, some of which will be flight capital and some accumulated savings earned abroad. Returning members of the diaspora are likely to be looking for new business opportunities. The post-conflict environment may offer abnormally high profits — owing to a less dangerous operating environment and expanded market. In addition to business opportunities, the diaspora is likely to be concerned about the quality of education and of health services. Families would have become used to the standards in their host country and may be reluctant to return to markedly lower standards. Since there is no way in which educational and health standards across the society can rapidly be raised to the required levels through public investment alone, it is necessary to encourage private provision of high quality services.

During conflict, sections of the diaspora are likely to have become politicized such that a government may well view them with suspicion. However, the onset of peace is an opportunity for the government to encourage the diaspora into a constructive

role. The diaspora business community is, after all, by far the most informed investor group in society. Properly treated, it is likely to be the first skill and capital inflow. It is also a useful barometer of obstacles to enterprises and so can guide the government in the myriad of microeconomic and administrative reforms that are likely to be needed. The best African example of successfully targeted post-conflict diaspora policies is Uganda. The exodus of Ugandan Asians was successfully reversed by combining an information campaign and the restitution of confiscated property. The legal process by which property was returned was particularly successful since it combined transparency, speed, and closure. All claims made prior to a set date were swiftly adjudicated, but claims not lodged by that date were not considered.

Sectoral policies

Breaking the construction bottlenecks

One of the legacies of civil war is a diminished construction sector, which is then overwhelmed by a sharp increase in demand for its services for post-conflict reconstruction. The result is a price boom for construction services, reflecting a steep supply curve.

There are several potential bottlenecks within the construction sector. Although Botswana does not face a post-conflict situation, it provides a good example of how bottlenecks can be overcome. Faced with bottlenecks, which constrained exceptionally rapid growth, the government implemented an annual plan specifically for the construction sector. Each year, construction firms were called in to discuss

the feasibility of government construction plans, and to identify and address bottlenecks. Construction requires land, material inputs, skills, organization, and finance. Each of these constitutes a potential bottleneck.

During conflict, urban land rights often become confused and this can delay post-conflict construction projects. For example, in both Sierra Leone and Angola there is chronic traffic congestion resulting from the ability of private households to import vehicles expanding far more rapidly than the government's ability to build roads, the stock of which has deteriorated due to decades of neglect. One reason for the delay in road building is the difficulty in public acquisition of the land on which roads need to be built. Hence, government legal action, whether through legislation or accelerated legal processes, may be needed to ensure that adequate land is available for construction projects.

Construction requires material inputs. Government planners should aim to break bottlenecks as swiftly as possible by drawing up a critical path showing the best prioritization sequence. Some inputs may be internationally non-tradable. In this case, some combination of economizing on the use of the input and prioritizing an increase in its local production will be appropriate. Some inputs, whether traded or not, may simply be expensive. In such cases, it is important to redesign projects to economize on their use. Even where there is a proximate port, the ability to import can become a bottleneck, either because of policy restrictions on imports, procedural restrictions such as customs, or the

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malfunctioning of the port. If the problem is the port, then port rehabilitation should become a priority.

Construction requires skills. While with appropriate technologies many unskilled workers can be employed; there are complementarities between skilled and unskilled workers. During conflict, the skills base in the construction sector of the economy is depleted as a result of forgetting-by-not-doing. These depleted skills include mundane skills like those required by bricklayers, welders, electricians and plumbers. Without these skills, the pace of reconstruction will be slowed, and precisely because the skills are mundane, the cost of importing them is high relative to the cost of local training. While restoring the stock of highly skilled people is a long and slow process, the mundane skills can be restored quickly. Again, the issue is one of giving early priority to potential bottlenecks, such that if skills are likely to become a bottleneck, training programs in these skills should be set up at the onset of peace.

The ability to organize production constitutes the entrepreneurial and managerial roles of firms. During conflict, economies lose many of their domestic construction firms and others become smaller. Recovering a stock of domestic firms takes time. In Botswana, construction contracts were tailored to accommodate the small size of most local firms, enabling them to grow rather than simply be bypassed by the public construction boom. The use of foreign companies can resolve the bottleneck in the organization of production. However, some foreign companies, notably Chinese companies, adopt a mode of operation ill-suited

to post-conflict conditions because they do not use sufficient local labour. This is important, given the need to create jobs for young people who are otherwise liable to resort to violence. Tenders for construction should be required to specify and commit to local employment levels so that choices among contractors can incorporate the employment objective.

The organization of simple reconstruction tasks may be well-suited to military organizations that have thrived during conflict. In post-war Europe and Japan, citizens and fighters were mobilized into public work gangs. This model may have benefits beyond the reconstruction work itself because it gives ordinary people a sense that they are participating in building a better future and that this endeavour is being directed by their government. Potentially, groups that were fighting units during the conflict may, given suitable opportunities, evolve into informal construction firms.

Financing may be a bottleneck for local construction firms. Credit is intrinsically scarce in post-conflict conditions because of the breakdown in trust and reputation, and it takes time to restore credit. A useful way of restoring credit is to establish fast track legal processes enabling banks to foreclose on collateral.

The extraction of natural resources

During prolonged conflict, companies extracting natural resources do so on terms that are highly favourable to them. Favourable terms for exploiting companies sometimes follow from competition between the government and the rebel organization: both may control territory

containing extractable resources and so can sell extraction rights. Favourable terms also compensate firms for the hazardous environment and abnormally high costs of operations. Clear evidence of this is provided by a study of the impact of the death of Jonas Savimbi on the stock market prices of resource extraction companies operating in Angolan diamonds. The death of Savimbi was unexpected, and so constituted financially significant news; it clearly marked the end of the prolonged civil war. While peace was evidently good news for Angolan society, it was treated as bad news for diamond extraction companies operating in Angola: the stock market prices of their shares fell significantly in reaction to the news (DellaVigna and La Ferrara, 2007). The most plausible explanation for this fall is that stockholders recognized that the bargaining power of the company had been reduced by the elimination of UNITA as a possible negotiating partner. As the fall in quoted stock prices indicates, companies expect that peace will bring renegotiation. Hence, a priority for post-conflict economic policy is to reach reasonable terms with resource extraction companies that are already operating. The potential sums involved are often very large relative to other sources of government revenue and so this is both urgent and important.

Peace also opens up the scope for the commercial extraction of deposits that were previously known but unviable during war conditions. The extraction of such resources requires the establishment of a tax structure that ensures profitable extraction, but captures a substantial proportion of the economic rents for the government.

Finally, peace opens up the scope for prospecting. This is especially important given current high commodity prices. Territories exposed to prolonged civil war are among the major remaining locations on earth yet to be prospected. However, the prospecting phase is not something to be rushed. Prior to licensing prospecting, the government should probably invest in a cadastre to reduce uncertainties. In general, private companies build in a high expected rate of return on uncertain prospects..

Renegotiation, the extraction of known but previously unexploited deposits, and the licensing of prospecting, all lead to a trade-off between current and future government revenues. Governments have two sources of revenues from resource extraction: initial one-off payments for extraction rights and a continuing flow of tax revenues from royalties and profits taxes. Clearly, the lower the future taxes, the more valuable the extraction rights. The temptation for fiscally stressed post-conflict governments is to bring revenues forward by committing to low future taxation, thus maximizing the price that companies are willing to pay upfront for extraction rights. However, this is likely to be very costly. Political uncertainties are inherent to the post-conflict situation: For this reason, long-term government commitments to low taxation are treated with suspicion by companies. Thus, governments sacrifice a lot of future revenues for each dollar of current revenue raised by such a strategy. Post-conflict governments cannot credibly commit to low long-term tax regimes as such commitments can be undone by future governments. The better strategy, therefore, is not to attempt to bring revenues forward,

but to instead adopt a tax regime that is reasonable from the outset, and, if possible, is modelled on tax regimes in countries with similar geological conditions.

Revenue management is another important issue, particularly for oil in the light of the current rise in prices. Care must be taken to avoid boom and bust cycles. The creation of societal trust funds is one option to be considered. Greater fiscal federalism, where resource rich regions get effective control over resource rents, as in Indonesia at present, should be pursued. This would dampen the tendency for secessionist rebellion in resource-rich regions. Murshed and Tadjoeddin (2007) find that the recent Indonesian experiment with fiscal federalism may be conflict-abating as it has increased the size of local government, which citizens value more than a distant federal government.

Two ongoing initiatives on corruption are worth pursuing. The first, "Publish What You Pay", as advocated by Global Witness, is meant to work through regulation of companies in countries where they are incorporated. Therefore, it is mainly a matter of corporate governance in developed countries. The second initiative is the Extractive Industries Transparency Initiative (EITI), proposed by the UK government as a voluntary code of conduct for participating host countries and companies.

Finally, extractive firms should be encouraged to exercise greater corporate social responsibility in countries in which they operate. This means that extractive firms should always consider the interests of society beyond their statutory obligations. They should take responsibility for the

impact of their activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as on the environment. In this regard, extractive firms must protect the communities they operate in from environmental damage as a result of their mining activity. They must also minimize disruptions to the lives of people in the community.

Integrating the rural economy into the market

Rural economies tend to retreat into subsistence during prolonged civil wars. The integration of smallholder agriculture into the market is thus a potential opportunity. Agricultural markets depend on transport and information. Since both of these are jeopardized by violent conflict, one of the legacies of war is that markets do not work well. This in turn has important corollaries. For example, household food security is impaired because food markets are not sufficiently dense to be reliable; while income uncertainty increases because of more volatile prices. On average, incomes are lower because of high geographic price dispersion due to low trade. The restoration of efficient rural markets is thus a priority. Private entrepreneurs are likely to make the needed investments in trucks, but the government should prioritize the complementary investment in rural roads and in information. By their nature, agricultural markets need speedy information on the spatial distribution of produce and prices. Mobile phones are well-suited to this function and so establishing an efficient and affordable network with effective coverage in rural areas is a priority.

The design of service delivery

A particularly urgent legacy of conflict is the deterioration in the provision of basic social services such as education and health care. The restoration of these services cannot be postponed because both are time-specific: if children miss schooling, then this cannot readily be offset by subsequent education; similarly, if the sick miss treatment.

However, states often lose the financing needed to pay for such services as well as the organizational capacity to deliver these services efficiently. Tracking surveys of social spending in Africa reveal some particularly high rates of leakage in post-conflict settings. Both the urgency of needs and expectations of change in post-conflict situations make it an appropriate moment to think afresh about the institutional architecture of service delivery. Indeed, the chance to rethink the provision of basic services makes the post-conflict situation an important opportunity for improvement. Just as the invention of mobile phones has enabled governments that were unable to provide adequate landline-based telecommunications to leapfrog to a superior technology, so does the post-conflict situation open up the possibility of institutional leapfrogging in service provision.

The conventional institutional architecture of service delivery in Africa is modelled on that of Europe in the 1950s: government ministries combine the functions of policy planning, resource allocation, and retail delivery of services with the aspiration to a monopoly of provision. Since the 1950s, Europe has rethought its mode of provision and has gradually moved away from this model. In

post-conflict Africa, where the civil service has collapsed and opportunistic behaviour is rife, the conventional model of state service delivery is particularly inappropriate. Similarly, the conventional donor post-conflict approach of attempting to rebuild state systems that have already comprehensively failed is a denial of reality. The economic theory of corruption explains why once a civil service has been comprehensively corrupted, incremental attempts at reform prove hugely difficult. Essentially, behaviour is locked into a pattern by the pressure of expectations. Once there is an expectation that civil servants will be corrupt, they have a much weaker incentive to be honest. This makes both honesty and corruption locally stable equilibria. Hence, within an honest system small perturbations into corruption can be quickly eliminated; conversely, in a corrupt system small perturbations into honesty tend not to persist. Thus, faced with the task of reforming a system that has collapsed into comprehensive corruption, it is more effective to create new institutions that are not so burdened with expectations of how employees will behave. As long as new institutions are well designed to include powerful incentives against corruption, realistic expectations of how staff will behave in them will break from the deadweight of past expectations.

A sensible starting point in redesigning service delivery is to separate the three functions of policy planning, resource allocation, and retail delivery of services. Policy planning is necessarily a political function that is appropriate for government ministries: this is the level at which the

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expressed political will of citizens must have effective power.

At the other end of the delivery chain — the retail delivery of social services through schools and clinics — there is a strong case for allowing as many separate organizations as possible to manage the provision of these services. Normal market-based competition is not desirable in social provision because it would require providers to get their revenues from users. It was the realization that provision of basic social services was not well-suited to the market that led to public provision. However, it is now possible to design institutions in such a way that they are either free or heavily subsidized to end-users, without provision being restricted to government-owned organizations. The key design feature is for governments to enter into contracts with organizations that directly provide the service.

The most obvious reason for allowing many separate organizations to provide basic services is that some will inevitably be better than others. This diversity allows funding to be gradually directed towards more effective providers. A related but distinct reason is that the very fact that there are multiple providers allows ‘yardstick’ competition. That is, the realization by providers that future funding depends on their performance relative to other providers stimulates the incentives provided by a market. A further, more sophisticated, reason for encouraging diversity is the scope it provides for better motivating workers. Motivation is critical in the delivery of social services because detailed performance by individual workers is difficult to monitor. It is therefore much more efficient to attract

workers who are self-motivated to work for the organization. Economic theory proposes, reasonably enough, that because potential workers differ in their beliefs and interests, it is helpful to offer them a range of organizations with different philosophies. People can then choose to apply for a job in organizations that most strongly motivate them. For example, some teachers may want to teach handicapped children, others may want to teach children who share their religion, and so forth. A diversity of independently managed delivery organizations enables this matching of motivations to organizations (Besley and Ghatak, 2003). One of the implications is that diversity in the mode of supply is likely to be a long-term feature of an efficient system.

Resource allocation, the third critical function, occurs between the functions of policy planning and that of retail service delivery to users: public money has to be channelled to retail providers to meet all or part of their costs. Where the civil service has become inefficient, this function is best placed with a separate public, but independent, institution, somewhat akin to an independent central bank or an independent revenue authority. By analogy, this may be termed an *independent service authority* (ISA). Ministries would set the policy objectives that such an implementing agency would be required to follow, but would not have direct operational authority on the allocation of public money. This separation of the policy function from the spending function not only slims down the functions of the ministries to a manageable core, but reduces the moral hazard of conflating policy setting with spending.

An independent service authority would receive funds from the government and donors and allocate them to retail service providers in accordance with contracts. Its core functions would be to negotiate and monitor these contracts, and measure the comparative performance of different organizations. Since it would not be part of the civil service, it would be free to recruit afresh, to pay appropriate salaries, and to link these salaries to performance. While an ISA would be a public institution, and its finances would be reported in the government budget, its supervisory board could include representatives of government, donors, and local civil society. One of the advantages of such wider representation is that this would increase the confidence of donors in the probity and effectiveness of the spending process, thereby augmenting the inflow of aid. The core function of the board would be to approve contracts, receive reports on performance under existing contracts, and ensure that resource allocation conforms with government policy as set out by the relevant ministries.

One of the political advantages of this model is that the pertinent government ministries would have to specify to the independent service authority the criteria by which resources should be allocated between localities and priorities. Since the criteria would need to be specified for the independent service authority, they would naturally also be public. In an integrated monopoly ministry, the government needs to have such criteria in order to make decisions; however, criteria that is only for internal ministry use does not need to be made public. In post-conflict environ-

ments, social groups, usually differentiated by locality, are understandably highly suspicious of each other. Each group will suspect that it is not getting its fair share of public spending. By forcing transparency into the political allocation process of public expenditure through the need for explicit instructions, an independent service authority can help build trust. Transparency, both in the actual decisions and in the criteria on which the decisions are based, is probably the best that can be done to defuse potentially dangerous political tensions. An independent service authority limits the power of government to make secret and discretionary reallocations of public spending to favoured groups: it is therefore an appropriate domestic restraint upon the abuse of power, targeted on an issue that is liable to be sensitive in the post-conflict context. In contrast, the attempt to re-establish integrated public monopoly ministries risks reviving precisely the most contested power centres.

Aid policies for post-conflict societies

Aid has the potential to play a critical role in post-conflict economic recovery. Three aspects make the post-conflict situation particularly suitable for aid. First, needs are acute: electorates in aid-providing countries expect their governments to support post-conflict recoveries. Second, the recovery is by its nature a time-limited phenomenon: the normal concerns about aid fatigue are less applicable because of the credible prospects for rapid recovery. However, beyond recovery, growth needs to be sustained over the medium-to-long term. This requires

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external financing to supplement domestic resources. Finally, many of the costs of violent conflict accrue to the neighbourhood. The costs of conflict reversion are thus not fully internalized by the post-conflict government, and donors therefore have a legitimate role in using aid to increase the pay-off to peace-promoting policies.

There is some evidence that despite the poor policy context, aid is atypically effective in raising growth in post-conflict situations (Collier and Hoeffler, 2004b). This suggests that post-conflict situations should probably receive more aid than would be warranted by a conflict-blind policy-based formula and many donors now make special provisions.

Over and above its effect on poverty reduction, aid could be peace-enhancing — the faster the growth of output, the lower the risk of conflict reversion. Thus, by raising output, aid helps reduce the risk of war recurrence. As indicated above, Adam *et al* (2008) find that aid reduces inflation in the post-conflict context, while Davies (2008a) finds that in post-conflict situations, capital flight is particularly sensitive to inflation. This implies that aid may indirectly enhance capital repatriation by lowering inflation.

However, a number of issues arise in the use of aid for post-conflict reconstruction and development. The first concerns the quality of aid and the delivery mechanism. The debate centers on whether budgetary support should be favoured to project aid. Budgetary support offers more flexibility and leaves the government free to spend the funds as it sees fit. This very advantage of budgetary support constitutes its principal potential weakness: the flexibility it offers

to a government can be abused, especially in post-conflict countries with weak institutions.

Project aid has its own problems. It offers less flexibility to the government and often leads to the setting up of a parallel institutional mechanism to administer the aid. In countries like Sierra Leone, project implementation units have been set to administer project aid. This has led to the cherry-picking of human resources from tertiary and government institutions (Davies 2008b).

The favourable effects of aid on the risk of conflict reversion maybe partially offset if aid inadvertently leaks into military spending. Because aid is fungible through various channels, it is therefore likely that some of it augments military spending. Collier and Hoeffler (2007) find that on average around 11 percent of aid finds its way into military spending. This result is not specific to post-conflict societies. However, if this is approximately the leakage in post-conflict situations, because aid inflows are large, it implies that a substantial proportion of the military budget of the typical post-conflict government is financed by aid. If so, this would be particularly worrying because, as discussed above, in post-conflict situations, government military spending seems to increase the risk of conflict. These concerns may constitute a reasonable basis for donors to negotiate limits on the military budget in return for aid.

A further concern about aid is the absorptive capacity of post-conflict governments. While needs are at their peak in the early post-conflict period, the administrative capacity of the government to spend public money well is at its nadir. Hence, there is a

case both for prioritizing improved mechanisms for public spending such as independent service authorities, and for phasing exceptional aid inflows more evenly over the decade rather than bunching them all in the first few years. The need for policy reform and the deterioration in the professional civil service suggests that technical assistance is particularly valuable during the post-conflict period.

The allocation of aid is also problematic. Over the past decade, aid allocation has gradually become more closely linked to attained levels of government performance. Since post-conflict governments inherit very poor policy performance, an exception has to be made for them. But the question is how long this exception should last. Potentially, aid to post-conflict governments may have two distinct elements, one that is unconditional and one that reflects attained performance. Over the course of the post-conflict period, the balance between these two elements may change. At the beginning, large aid inflows would be warranted purely on the basis of need and opportunity. However, over time, aid allocation would gradually depend more heavily on attained performance. This would enhance the incentive for governments to adopt reforms. Finally, the classic problems of temporary aid booms — Dutch disease, construction booms, public expenditure commitments that are difficult to reverse, temporary trade liberalizations that are gamed by importers — are all likely to arise. However, these may be fully offset by the core underlying rationale for aid in these contexts: that the economy has an acute but temporary need for additional resources.

Another issue is that aid is never apolitical. Aid strengthens the government and implicitly weakens the opposition, and this may fuel conflict. This constitutes one of the arguments for pushing for clear peace commitment mechanisms — such as signing peace accords that include specific power-sharing arrangements — as part of aid conditionality.

Beyond post-civil conflict

The core of this chapter has considered the post-conflict context; however, there are related contexts of actual and potential violence that warrant further discussion.

Africa has not had many international wars, but it has not completely escaped them. As a result, in parts of Africa, most notably the Horn of Africa and Central Africa, neighbouring governments are highly suspicious of each other. This creates two economic problems: arms races and interruptions to trade routes.

Neighbourhood arms races occur around the world. In effect, an increase in military spending by one country forces neighbouring countries to increase their military spending simply to preserve their initial level of security. Hence, military spending is a neighbourhood public bad. Like other public bads, it needs to be curtailed through coordinated action. A neighbourhood might agree on a target rate of reduction that each government should implement. President Arias of Costa Rica is currently leading an initiative in Central America to de-escalate arms spending in a coordinated fashion. Africa, with its multiplicity of small states, each with several neighbours, is the other region of the world

in which such an initiative would be highly appropriate. To be credible, any commitments to reduced military spending must be supervised by an agreed but independent verification process. In Africa, the African Development Bank is well-suited to such a role. The problem of high neighbourhood military spending is particularly acute if neighbours have actually had a war. Once a country has been involved in an international war, its level of military spending remains high for decades. In effect, governments appear to be taking the view 'once bitten, twice shy'. Since the typical international war is brief, an unfortunate implication is that most of the costs of such wars occur after they are over, due to the elevated level of military spending. Hence, negotiated mutual reductions in military spending following international wars or periods of heightened tension within a neighbourhood can be valuable.

The other disturbing consequence of international conflict is the closure of trade routes. The clearest such case at present is the diversion of Ethiopian trade away from the least cost route to the coast, which would be through Eritrea. Given the large number of landlocked countries in Africa, it would be valuable if the region's political institutions could negotiate agreements, supported by credible penalties, enabling guaranteed access to the coast for landlocked countries.

Finally, some types of internal political violence are below the scale of civil war but nonetheless have important economic consequences. One example is the recent political disturbance in Kenya. One of the

side-effects was the prolonged closure of Uganda's trade route to the coast. It is a further example of the damage that might at least have been curtailed had the Kenyan government pre-committed itself to an agreement whose breach would have triggered substantial compensation to Uganda. While the need to provide compensation would not have deflected the course of the political disturbances, it would probably have induced the government of Kenya to place more priority on keeping the transport route open, clearly something within its military power. A second example is the violence in the Delta region of Nigeria. Oyefusi (2008) surveyed more than a thousand young men in the Delta region to determine why many of them had joined violent gangs. Oyefusi found that there was no relationship between the social facilities of a district and the propensity of young men to join violent gangs. Rather, the main driver was the presence of oil wells. The evidence was consistent with the violence having transmuted from its origins in political protest into extortion rackets against oil companies. As with other forms of violent crime, the best policy response may be some combination of employment opportunities targeted at young uneducated males, and intensive policing.

Conclusion

Rapid post-conflict economic recovery is both valuable and feasible. However, recovery often depends on three distinct actors: The post-conflict government, whose task is to reform economic policies that are likely initially to be dysfunctional. Donors, whose role is to provide both exceptionally

large financial inflows, despite initially poor policies, and technical assistance to help governments implement reform. Finally, in appropriate cases, the Security Council and the African Union, provide peacekeepers. Each of these roles requires about a decade — rather than just the first few years — of peace: there is usually no quick solution to conflict, and full economic recovery may take more than a decade.

The roles of these three actors are interdependent. Without rapid economic reform, aid is less effective and unlikely to be sustained throughout the decade. Without the combination of reform and aid, risks of conflict reversion may not fall sufficiently to provide a credible exit strategy for peacekeeping where it is undertaken. Without peacekeeping, the risks of conflict reversion may be so high that they will discourage the return of the diaspora and deter private investment.

The need for a long-term perspective on recovery and the interdependence of decisions pose a challenge: In the early years of a typical post-conflict situation, actors are

often in fire-fighting mode, and coordination is weak. There is thus a case for a ‘template’, or ‘compact’ that, while not legally binding, would set out the expected roles of each actor over the course of the decade. Governments would commit to economic reform, donors would commit to large inflows of finance and technical assistance sustained over the decade, and peacekeepers would commit to the provision of long-term security — perhaps as the UK did for Sierra Leone — evolving into an ‘over-the-horizon’ commitment after the first few years. The purpose of such a compact would be to recognize the interdependence between actors and the long-term nature of the recovery process.

What are the implications for the African Development Bank? The Bank has four different roles, each of which needs to be distinctive in the post-conflict setting: advice, capacity building, finance and advocacy. This has motivated the Bank to design new instruments for intervention in fragile states, most of which are post-conflict countries. These initiatives are discussed in the next chapter.