

SECTION 9

SUSTAINABLE ECONOMY

Macroeconomic Stabilization

- Monetary Stability
- Fiscal Management
- Legislative and Regulatory Framework

Control Over the Illicit Economy and Economic-Based Threats to Peace

- Control Over Illicit Economic Activity
- Management of Natural Resource Wealth
- Reintegration of Ex-Combatants

SUSTAINABLE ECONOMY

Ability of the people to pursue opportunities for livelihoods within a system of economic governance bound by law.

Employment Generation

- Quick Impact
- Agricultural Rehabilitation
- Livelihood Development

Market Economy Sustainability

- Infrastructure Development
- Private Sector Development
- Human Capital Development
- Financial Sector Development

Sustainable Economy

Ability of the people to pursue opportunities for livelihoods within a system of economic governance bound by law.

9.0 What is a sustainable economy?

A sustainable economy⁴⁸⁴ is one in which people can pursue opportunities for livelihoods within a predictable system of economic governance bound by law. Such an end state is characterized by market-based macroeconomic stability, control over the illicit economy and economic-based threats to the peace, development of a market economy, and employment generation. Economic governance refers to the collection of policies, laws, regulations, institutions, practices, and individuals that shape the context in which a country's economic activity takes place.⁴⁸⁵

9.1 What are the key economic challenges in societies emerging from conflict?⁴⁸⁶

Violent conflict can severely devastate an economy. Large-scale violence disrupts market activity by destroying infrastructure and critical production and processing facilities. Common features of a war-torn economy include macroeconomic instability, fragmented markets, limited access to credit, reduced confidence, depleted human capital, increased illicit economic activity, mine-littered lands, and debilitated economic institutions that are vulnerable to capture by predatory economic actors⁴⁸⁷ or spoilers. States may be captured by a political-criminal nexus sustained through hidden economic transactions, which threaten peace, governance, and development. Major hostilities also deplete the labor market by driving families from their homes and killing, traumatizing, or disabling millions of others. An overall decline in the well-being of the population is common, as the government diverts public service investments to finance military operations or the state collapses and is unable to make necessary investments.

9.2 Why is a sustainable economy a necessary end state?

Once violent conflict has ended, countries still face alarming risks of falling back into conflict. Broad consensus exists that sustainable welfare-enhancing economic growth has the potential to mitigate these risks by improving living standards, reducing inequalities among groups, increasing affordability of basic goods and services, and expanding overall opportunity.⁴⁸⁸ Economic opportunity and growth give the population a stake in peace,

484. "Sustainable economy" is a term of art used in existing literature. For the purposes of this manual, this term is intended to broadly encompass the ability of the people to pursue opportunities for livelihoods within a system of economic governance bound by law.

485. United States Agency for International Development, *Economic Governance in War Torn Economies: Lessons Learned from the Marshall Plan to the Reconstruction of Iraq*, 2004. Hereafter: USAID, *Economic Governance in War Torn Economies*, 2004.

486. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

487. For the purpose of this manual, "predatory actors" broadly refer to any group or individual that engages in or directly benefits from illegal economic activity that promotes violence and/or undermines efforts for good governance and economic development. These actors can exist inside or outside of government.

488. United States Agency for International Development, *Guide to Economic Growth in Post-Conflict Countries*, 2009. Hereafter: USAID, *Guide to Economic Growth*, 2009. Paul Collier, *Post-Conflict Recovery: How Should Policies Be Distinctive?* 2007. Hereafter: Collier, *Post-Conflict Recovery*, 2007.

particularly local entrepreneurs. Although it is rarely the sole precipitating cause of violent conflict, economic failure has proven to be a key factor that can mobilize political and social grievances into large-scale violence. Without broad improvements in economic performance, peace is not sustainable.

9.3 What are the necessary conditions to achieve a sustainable economy?

- *Macroeconomic Stabilization* is a condition in which monetary and fiscal policies are established to align the currency to market levels, manage inflation, and create transparent and accountable systems for public finance management. This condition requires a robust and enforceable legislative and regulatory framework to govern issues such as property rights, commerce, fiscal operations, and foreign direct investment.
- *Control Over the Illicit Economy and Economic-Based Threats to Peace* is a condition in which illicit wealth no longer determines who governs, predatory actors are prevented from looting state resources, ex-combatants are reintegrated and provided jobs or benefits, and natural resource wealth is accountably managed.
- *Market Economy Sustainability* is a condition in which a market-based economy is enabled and encouraged to thrive. Infrastructure is built or rehabilitated, and the private sector and the human capital and financial sectors are nurtured and strengthened.
- *Employment Generation* is a condition in which job opportunities are created to yield quick impact to demonstrate progress and employ military-age youths, and a foundation is established for sustainable livelihoods.

9.4 General Guidance for Sustainable Economy

9.4.1 Build host nation ownership and capacity. Consult broadly and create coordination mechanisms with the host nation population to build trust, prevent dependency, and ensure ownership, paying particular attention to women and minorities who may have special needs. Recognize that the civil service in line ministries makes up the core of the government workforce and must be trained and paid. Small business development—particularly in the agricultural sector—should build on and enhance host nation capacity. Even while peace negotiations are ongoing, start a dialogue with civil society and private sector representatives to build political consensus for the economic recovery program.⁴⁸⁹ Also be certain to recognize work that is accomplished by the population through strategic communications.⁴⁹⁰

9.4.2 Act only with an understanding of the local context. War-torn economies may share many characteristics, such as physical insecurity, weak state capacity to enforce taxes or regulate the economy, inability to adjudicate economic disputes, macroeconomic instability (volatile currency, high inflation), decreased production, a distorted labor market, a loss of human capital, informal economic activity, a drop in GDP, and

489. Organisation for Economic Co-Operation and Development, *Economic Reconstruction in Post-Conflict Transitions: Lessons for the Democratic Republic of Congo*, 2003. Hereafter, OECD, *Congo*, 2003. USAID, “Guide to Economic Growth,” 2009.

490. JICA, “Handbook for Transition Assistance,” 2006. Jill Shankleman, *Managing Natural Resource Wealth* (Washington, D.C.: U.S. Institute of Peace, 2006). Hereafter: Shankleman, *Managing Natural Resource Wealth*, 2006.

a return to subsistence agriculture.⁴⁹¹ But there is no single strategy that can be applied across the board. Tailored, conflict-sensitive approaches are necessary to account for unique characteristics in the political and economic landscape.⁴⁹² The economic assessment should investigate key aspects of the specific context:⁴⁹³

- What is the extent of the disruption to commerce and general economic activity?
- What is the extent of damage done to physical infrastructure and social and political institutions?
- What is the competitive advantage of economic structures predating the conflict?
- What is the legacy of conflict-related economies?
- What is the state of livelihoods, including skills, capacity, motives, and access to resources?
- What is the state of macroeconomic policies and institutions and government resources?
- What is the state of industries, investment, trade, and markets?
- What is the potential impact of international actors on the domestic economy?

9.4.3 Prioritize to stabilize. Economic recovery programming should not be development as usual. Political imperatives and the need to maintain peace should trump goals of economic efficiency in the immediate aftermath of violent conflict.⁴⁹⁴ Principles of inclusivity and balance can avoid perceptions of inequality in wealth distribution. While no consensus exists on the exact sequencing of economic reforms, most agree that more attention must be paid to macroeconomic stabilization, alongside emergency activities such as infrastructure rehabilitation or the reintegration of ex-combatants.⁴⁹⁵ S&R missions have typically postponed fiscal and monetary reform, which is key to creating favorable conditions for growth.⁴⁹⁶ Acting early in these reforms is vital, when political resistance tends to be low.⁴⁹⁷ Other economic priorities in these environments include addressing property rights by developing dispute resolution mechanisms and enforcing laws to combat organized crime and other destabilizing economic activity.

See Trade-off: Section 9.9.1, Economic efficiency vs. political stability.

9.4.4 Use a conflict lens. Be cautious that economic growth strategies do not reinforce or empower predatory economic actors. After violent conflict is over, these are often the key economic players that emerge and are frequently associated with crime and corruption. Also recognize that all economic recovery activity is fundamentally politi-

491. JICA, "Handbook for Transition Assistance," 2006. USAID, "Guide to Economic Growth," 2009. Jonathan Haughton, *The Reconstruction of War-Torn Economies and Peace-Building Operations*, 2002. Hereafter: Haughton, *Reconstruction of War-Torn Economies*, 2002.

492. USAID, "Guide to Economic Growth," 2009. United States Agency for International Development, "Accelerating the Transition From Conflict to Sustainable Growth," 2008. Hereafter: USAID, "Accelerating the Transition," 2008. Haughton, *Reconstruction of War-Torn Economies*, 2002.

493. JICA, "Handbook for Transition Assistance," 2006.

494. OECD, "Congo," 2003.

495. USAID, "Economic Governance in War Torn Economies," 2004.

496. UNDP/USAID, "First Steps," 2007. Haughton, "Reconstruction of War-Torn Economies," 2002.

497. USAID, "Accelerating the Transition," 2008.

cal in these societies. Understanding all actors and their complex political-economic relationships helps to avoid strengthening historical inequities that may have led to violent conflict in the first place.⁴⁹⁸ Every decision, from choosing which roads to rehabilitate first to choosing a currency, can have political ramifications. Always consider political impacts before taking action.

9.4.5 Recognize interdependence. Successful economic recovery depends on multiple aspects of the S&R mission, so be sure to address it comprehensively. For example, security is essential for expanding economic activity and allowing farmers or merchants to travel safely to the market place. A predictable legal framework for resolving property rights or contract disputes is key to encouraging business investments and preventing renewed conflict. Good governance over natural resource wealth is vital for boosting the effectiveness and credibility of the state and removing a persistent source of conflict. Recognize these linkages and coordinate economic strategies with those of security, the rule of law, governance, and social well-being.

9.5 Necessary Condition: Macroeconomic Stabilization

9.5.1 What is macroeconomic stabilization? Why is it a necessary condition?

Macroeconomic stabilization is a condition in which a complex framework for monetary and fiscal institutions and policies is established to reduce volatility and encourage welfare-enhancing growth. Achieving this condition requires aligning currency to market levels, managing inflation, establishing foreign exchange facilities, developing a national budget, generating revenue, creating a transparent system of public expenditure, and preventing predatory actors from controlling the country's resources.⁴⁹⁹ It also requires a framework of economic laws and regulations that govern budgetary processes, central bank operations, international trade, domestic commerce, and economic governance institutions. Stabilization of the economy is a prerequisite for economic growth. Empirical evidence shows that creating an environment that is conducive to higher rates of investment can reduce the likelihood of violence, while economic growth has a positive correlation with job creation and higher living standards.⁵⁰⁰

9.5.2 Guidance for Macroeconomic Stabilization

9.5.3 Approach: Monetary Stability

Monetary stability is a subjective approach as there are varying degrees to which people seek to achieve it. In the early phases of recovery, this approach may involve stabilizing the currency, bringing inflation and foreign-exchange rates to levels consistent with sustainable growth, promoting predictability and good management in the banking system, and managing foreign debt.⁵⁰¹ The primary authority is usually an independent central

498. Raymond Gilpin, "Toward Conflict-Sensitive Macroeconomic Growth: Unraveling Challenges for Practitioners," presented at Building Capacity in Stability Operations: Security Sector Reform, Governance and Economics, *United States Army Peacekeeping and Stability Operations Institute and Center for Naval Analysis*, 2009. Hereafter: Gilpin, "Conflict-Sensitive Macroeconomic Growth," 2009.

499. UNDP/USAID, "First Steps," 2007.

500. Gilpin, "Conflict-Sensitive Macroeconomic Growth," 2009.

501. USAID, "Economic Governance in War Torn Economies," 2004.

bank that controls or stimulates the overall economy by manipulating the money supply and interest rates, within the parameters of monetary policy.⁵⁰²

9.5.4 Assess the state of monetary stability. An important step in achieving monetary stability is to assess current and past monetary conditions, including the state of the money supply and inflation, currency use, budget deficits, and debt. This assessment, typically performed by the International Monetary Fund (IMF) and World Bank, should also gauge the functionality of various government institutions and staff. Key questions to ask include the following:

- What is causing inflation?
- How much money is in circulation in both the formal and informal economies?
- How deep are the financial markets?
- Are interest rates realistic?
- Are banking institutions intermediating effectively?
- What is the effect of informal finance and remittances?
- What is the condition of nonbank financial institutions?

9.5.5 Inform monetary decisions by setting up a system for collecting economic data. The ability to collect and analyze economic data is key to sound monetary policymaking process. Although statistics offices are often ignored in war-torn countries, the host nation government and international actors need to understand what is actually happening in the economy. In the emergency phase, assist the host nation government in establishing an interim mechanism to collect timely information on consumer prices, balance of payments, and other monetary statistics.⁵⁰³ Late attention to statistics offices could force finance ministries to conduct ad hoc statistical analyses to construct the consumer price index, GDP estimates, and national accounts.⁵⁰⁴

9.5.6 Address macroeconomic stabilization early on; it is an oft-overlooked priority.⁵⁰⁵ While no consensus exists on the exact sequencing of economic reforms, there is agreement that more attention must be paid to macroeconomic stabilization early on. This is critical for establishing a payment system, managing inflation, and laying down a basis for economic growth. S&R missions have typically prioritized emergency measures such as infrastructure rehabilitation, while postponing the reform of monetary and fiscal institutions and policies that are key to creating favorable conditions for growth.⁵⁰⁶ Some macroeconomic measures that may happen early on include opening up to trade, finding an appropriate exchange rate, managing inflation, and bringing the budget deficit to a manageable level.⁵⁰⁷

See Trade-off: Section 9.9.4, Macroeconomic reforms vs. political stability.

502. JICA, "Handbook for Transition Assistance," 2006.

503. JICA, "Handbook for Transition Assistance," 2006.

504. USAID, "Economic Governance in War Torn Economies," 2004.

505. Ibid. Haughton, "The Reconstruction of War-Torn Economies," 2002.

506. UNDP/USAID, "First Steps," 2007. International Peace Academy and Center for International Security and Cooperation, *Economic Priorities for Peace Implementation*, 2002. Hereafter: IPA, *Economic Priorities*, 2002.

507. Haughton, "Reconstruction of War-Torn Economies," 2002. IPA, "Economic Priorities," 2002. Paul Collier, "Introduction," in *Demobilization and Insecurity—A Study in the Economics of the Transition from War to Peace*, 1994.

9.5.7 Build public confidence by stabilizing domestic currency. An unstable currency is bad for the economy because it is inflationary and can cause scarcity and depletion of resources. As a result, many people may convert their savings into foreign currencies during and after conflict, usually euros or dollars. Others will hoard cash in their homes.⁵⁰⁸ Suppressing this trend is often unsuccessful and may not be a priority—with time, domestic currency will eventually be used in local transactions and in paying taxes to the government.⁵⁰⁹ Host nation governments have a number of options for stabilizing their currencies, including using preexisting currency, introducing a new national currency, or borrowing foreign currency from another country.⁵¹⁰ The most suitable approach will depend on the political situation but should seek to address supply bottlenecks, shore up reserves, strengthen institutions, and create a domestic market.

9.5.8 Stabilize the exchange rate through a foreign exchange market.⁵¹¹ An organized foreign exchange market that allows countries to buy and sell currency aids stabilization. Develop transparent policies for participation in foreign exchange auctions. Following violent conflict, the exchange rate is often overvalued because of restrictions on imports and other distortions that favor those with access to the foreign exchange at the official rate. There are several policy choices for foreign exchange. When the value of the currency is known, countries can either peg their currency to a major international currency or continue to let their currency float. By submitting to external discipline, pegging a currency foregoes autonomous monetary policy, which can be beneficial in countries trying to stabilize inflation and restore credibility after the conflict.⁵¹² An open exchange rate, however, may make sense for countries with insufficient reserves to maintain a fixed exchange rate.⁵¹³

9.5.9 Set realistic targets for inflation rates. Inflation is often high in war-torn economies. This may be the case because the government resorted to printing money to fund its military costs, among other factors. Stabilizing inflation is important to restore public confidence in the value of domestic currency, invite greater investment, and provide businesses with a guide for what to produce and in what quantities.⁵¹⁴ However, it is important not to go too far. Focusing on managing reserves and debt may be more realistic and effective. Imposing traditional economic reform agendas used in ordinary developing countries may not be appropriate for a country that has just undergone violent conflict. The effect could be to exacerbate social polarization and political disintegration.⁵¹⁵ Neither actors nor institutions in these countries tend to respond to traditional policy prescriptions the way one might expect in a country that is already on a strong path to development.

9.5.10 Build the institutional capacity of an independent and credible monetary authority. A credible monetary authority typically exists in the form of a central bank that is able to

508. JICA, “Handbook for Transition Assistance,” 2006.

509. Houghton, “Reconstruction of War-Torn Economies,” 2002.

510. USAID, “Economic Governance in War Torn Economies,” 2004.

511. USAID, “Guide to Economic Growth,” 2009.

512. Houghton, “Reconstruction of War-Torn Economies,” 2002.

513. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner’s Guide*, 2007.

514. Ibid.

515. Gilpin, “Conflict-Sensitive Macroeconomic Growth,” 2009.

implement monetary policy decisions without political influence. In cases where it is necessary to develop a central bank, think about reducing the printing of money, replenishing foreign currency, jumpstarting foreign exchange operations and setting up accounting and statistical systems. Training and technical assistance are also important for both high-level officials and central bank staff.⁵¹⁶ The primary functions of a central bank include the following:

- Controlling the emission of domestic currency
- Restoring the payments system
- Facilitating or serving as a market for foreign exchange
- Supervising commercial banks.

9.5.11 Strive for relevance, transparency, and effectiveness when developing a banking system. In the early stages, focus on creating a relevant, transparent, and effective banking regime that is capable of mediating between savers and investors. Do not focus too heavily on creating a sophisticated financial sector. Banking policies should focus on establishing rules for transparency, preventing bad loans, and avoiding political lending.

9.5.12 Approach: Fiscal Management

Effective fiscal management requires building a transparent and accountable system for collecting revenue, spending public funds, and managing domestic debt. Fiscal policy is the use of the state budget to affect an economy through revenue collection and payments for goods and services and must be established early. A fiscal authority is needed to implement policy and manage fiscal operations, all of which will be a challenge when there is very limited administrative capacity. See Section 8.6 for a discussion on the stewardship of state resources.

See Gap/Challenge: Section 9.10.6, Public finance management.

See Trade-off: Section 8.9.4, Responsible fiscal management vs. the need to provide immediate services.

9.5.13 The fiscal authority should be effective and transparent. A finance ministry is typically the authority responsible for managing fiscal operations. While the precise institutional structure, powers, and responsibilities of that authority will vary depending on the country, the goals are often the same: ensuring that fiscal decisions are made in a predictable rather than ad hoc manner, establishing transparency in fiscal operations, collecting revenue, and ensuring that public spending matches the national priorities. These are fundamental for stabilization. Given weak administrative and technical capacity, simplicity is key. The fiscal authority usually includes four departments with the following functions:⁵¹⁷

- A budget department to coordinate the spending program and create the budget
- A treasury to control spending, ensure funds are accounted for, transfer state revenues into bank accounts, and record transactions transparently;
- Customs and domestic tax departments for implementing tax policy and collecting tax revenues.

516. USAID, "Guide to Economic Growth," 2009.

517. United Nations University, *Strategy for Rebuilding Fiscal Institutions*, 2007.

Donors should coordinate a technical assistance strategy at the outset and provide long-term advisers to account for weak capacity.⁵¹⁸

See Gap/Challenge: Section 8.10.4, Oversight and accountability.

9.5.14 Do not ignore revenue generation strategies to meet urgent needs in these environments. After violent conflict, the government will need revenue to resume the provision of basic goods and services, finance key reconstruction projects, and address large macroeconomic imbalances. Significant revenue mobilization, however, will be challenging because of a shrunken tax base, complex or discriminatory tax policies, weak institutional capacity, and competing illicit economies. One of the primary means for collecting revenue is getting the tax system up and running by securing the necessary infrastructure, technical assistance, and monitoring or oversight mechanisms. Another means for generating revenue quickly is through transparent and accountable management of natural resource wealth. Natural resource wealth management is also discussed in Sections 8.6.25 and 9.6.11.

9.5.15 Stress simplicity in developing tax systems and policies, given limited administrative capacity. In these environments, there typically is limited capacity to administer a complex tax system. Rather than imposing direct taxes on personal income that could be difficult to implement, taxation could start with simple, indirect taxes on sales at hotels or restaurants. Simple taxes on international trade—sales taxes on exports and excise taxes on imports—may also be relatively easy sources of revenue. The concept of simplicity should be applied to tax administration as well, focusing primarily on the most basic aspects of operation in early phases, such as procedures for filing and paying taxes and registration checks. With time, the focus of attention should shift toward improving the capacity for tax efforts and broadening the tax base.

See Trade-off: Section 9.9.2, Sophistication vs. simplicity in the income tax system.

9.5.16 Accept low tax rates on earned income in the emergency phase. Sustainable tax revenue requires long-term investment in nurturing the formal economy and fostering a culture of compliance in paying taxes.⁵¹⁹ While revenue collection programs are necessary, they can also be counterproductive when pursued too aggressively in the immediate aftermath of violent conflict—raising taxes too heavily contradicts the central goal of economic recovery and can undermine the credibility of the government. Prepare to accept a prolonged period in which tax rates on earned income are low. The focus instead should be on jumpstarting economic activity by breaking down barriers, establishing new farms or businesses, and expanding operations. How the economy expands will shape the strategy for taxing different sectors.⁵²⁰

9.5.17 Consider debt relief programs to achieve debt sustainability. Many governments in countries emerging from violent conflict will have accumulated unsustainable debt burdens while immersed in the conflict. In these cases, debt service relief may be a critical element to recovery.⁵²¹ The design and implementation of debt relief programs

518. International Monetary Fund, *Rebuilding Fiscal Institutions in Post-Conflict Countries*, 2004. Hereafter: IMF, “Fiscal Institutions,” 2004.

519. Collier, “Post-Conflict Recovery,” 2007.

520. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner’s Guide*, 2007.

521. Raymond Gilpin, “Debt Relief in Fragile States,” presented at Debt Relief and Beyond: A World Bank Conference on Debt and Development, The World Bank, April/May 2009.

should be tailored to account for the unique complexities of each country's political economy. These variations can include the speed of delivery, the scope of resources, performance triggers, and the exit strategy. Debt relief should be viewed as part of a long-term effort that includes a comprehensive and robust debt management strategy, and should address all conflict-era debts and forestall commercial borrowing.

9.5.18 Be prepared to fill the gap between revenue and government costs with funding from international actors. Inevitably, the host nation government will come up short on revenue in the emergency phases because stabilization costs are high and capacity is low. In these emergency stages, international actors should be prepared to serve as the primary source of funds. But as the host nation government begins to strengthen its taxation capacity, international actors should shift their role to filling funding gaps. Making this shift is challenging. International actors should help the host nation government in this transition by carefully assessing recurrent costs for both salaries and capital expenditure programs and establishing clear goals for achieving self-sufficiency.

9.5.19 Strengthen public expenditure management (PEM) of the host nation government. Getting a PEM system up and running requires transparent processes and sound institutions, policies, and regulations. Strengthen budget execution by enhancing administrative and technical capacities of ministries. The ministries will have to draft budget documents and develop executive expenditure authorization procedures to monitor and control spending across the government. Audit capacities are essential and should be strengthened, alongside reforms in the fiscal conduct code, to limit corruption, waste, and misappropriation of public funds.⁵²² Address bottlenecks in spending and generate controls within the executive branch, legislature, international community, and civil society, all of which play critical roles in ensuring accountability of public spending.⁵²³ Payment for government salaries and essential services (police, schools, clinics, or other operating units) should come from the finance ministry and should not be under the control of the heads of each operating unit.

9.5.20 Prioritize transparency in contracting and procurement practices to combat corruption. Contracting processes are one of the greatest sources of corruption in many countries. The best ways for curbing corruption in contracting processes are to establish simple and practical rules and procedures, accompanied by impartial and consistent decisions and a means for holding the contracting agency and contractors accountable for their actions. Implementing controls such as requiring dual authorization of expenditures and audits (i.e., from the manager and accounting clerk), can help restrict grafting practices.⁵²⁴ The World Bank has developed guidelines on how to standardize the establishment of open, transparent, and competitive contracting procedures.⁵²⁵ At stake are critical resources, necessary services, and the financial credibility of the operation, all of which outweigh the need to be more efficient. Other aspects of corruption are discussed in Sections 8.6.20 to 8.6.22 and 9.6.

522. IMF, "Fiscal Institutions," 2004.

523. Ghani/Lockhart, *Fixing Failed States*, 2008.

524. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

525. World Bank, "Contracting and Procurement Guidelines," 2004. <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/CSO/0,,contentMDK:20094613~menuPK:220448~pagePK:220503~piPK:220476~theSitePK:228717,00.html>, accessed June 22, 2009.

9.5.21 Reflect national interests in budget and state spending. Although administrative capacity is weak, the host nation government should begin keeping budgetary records and ensuring that the national budget is aligned with citizens' interests, including civil service pay and infrastructure investments.⁵²⁶ Before preparing a budget, the government needs a mechanism by which to execute the budget—a treasury system and spending information management system that allows the state to monitor all expenditures. The treasury should promote predictability, transparency, and timeliness in paying civil servants and procuring goods and services.⁵²⁷ Improving budget management can help prevent state funds from being siphoned off for illegitimate purposes and promote spending that is consistent with the official budget. Some budgetary execution challenges are rooted in inexperience and unrealistic estimates about the capacity to implement projects in the budget.

See Trade-off: Section 9.9.3, Creating donor trust funds vs. strengthening the host nation budget process.

9.5.22 Approach: Legislative and Regulatory Framework

A legal, institutional, and regulatory framework is necessary to guarantee proper operation of economic institutions to address stabilization challenges such as property rights.⁵²⁸ This framework must be simple, transparent, and easily enforceable, and it should address a range of laws governing commerce, labor, and property rights and mechanisms for institutional oversight and fiscal operations. Economic laws are worthless in this environment unless an effective legal system is capable of enforcing the law. This framework, together with broader economic recovery, can provide a foundation for greater investment and growth.⁵²⁹

9.5.23 Assess legal conditions and simplify wherever possible. In reviewing existing legislation, the goal should be to redress discriminatory practices linked to the conflict and simplify wherever possible to account for what will likely be weak administrative capacity. There is often a mismatch between the administrative capacity of host nation actors and the complexities of laws, particularly tax laws and administrative procedures. Consult widely in both the public and private sectors (informal and formal, on all sides of the conflict) to identify barriers to economic activity.⁵³⁰ As soon as possible, remove those barriers, including onerous business registration procedures or restrictions on who may apply for import licenses. Laws may need to be drafted or imported and must be understood by domestic courts and the population. See also Section 7.5 for more on assessing and reforming legal frameworks.

9.5.24 Promote predictability, open markets, and fair competition through commercial laws.⁵³¹ Having a strong national policy and regulatory environment that embraces these tenets is key to creating favorable conditions for a market economy. Stability and predictability are critical to markets, enterprises, and foreign direct investment. Remove ambiguities in the investment code to allow foreign firms to borrow locally,

526. Ghani/Lockhart, *Fixing Failed States*, 2008. JICA, "Handbook for Transition Assistance," 2006.

527. Ghani/Lockhart, *Fixing Failed States*, 2008.

528. Covey/Dziedzic/Hawley, *Quest for Viable Peace*, 2005.

529. OECD, "Congo," 2003.

530. USAID, "Guide to Economic Growth," 2009.

531. Johanna Mendelson Forman and Merriam Mashatt, *Employment Generation and Economic Development in Stabilization and Reconstruction Operations* (Washington, D.C.: U.S. Institute of Peace, 2007). Hereafter: Mendelson Forman/Mashatt, *Employment Generation*, 2007.

allow expatriates to get work permits, and avoid corruption and red tape. Create laws that govern contracts (pledges, loans, and mortgages), bankruptcy (for companies that reorganize or liquidate themselves), and commercial and financial transactions. Establish rules of the game by regulating quality standards in major industries and establishing processes for business license registration, whether for partnerships or corporations, domestic or foreign.⁵³² The legal regime for commerce should also be perceived as favoring free and open markets and ensuring a level playing field for firms. Address market failures and prevent any special privileges or advantages for some sectors. These policies will likely contrast with the conflict-era or pre-conflict era environment in which the privileged few had access to economic opportunity. In cases where ownership was concentrated or state-held, privatization and competition laws are needed.

9.5.25 Develop a customs, tax, and budget legal framework to govern fiscal operations.

Laws governing fiscal operations have two main sources: the constitution and tax and budget laws. The constitution typically specifies the division of government taxing powers while tax laws authorize the state to collect taxes and enforce the law when taxes are evaded. Financial regulations are also necessary to authorize the fiscal authority to manage public spending. The goal in creating tax regulations and laws should be to simplify them, make them more transparent, and make them easier to administer. A budget law should set out clear budget classification structures that establish guidelines for executing the budget, such as prohibiting unbudgeted spending, creating a framework for internal control and audit, and providing a means for financing budget deficits. New laws should also address how to deal with situations involving “off-budget transactions,” the absence of clear classification of budgetary spending, and the absence of procedures for managing foreign aid.

9.5.26 Prioritize dispute resolution mechanisms to address property and contract issues.

Land and property rights disputes dominate in these scenarios. During violent conflict, the state often seizes property or other assets to support its efforts. People flee, land is abandoned, and others take control. The inflow of returnees looking to reclaim land creates a major problem. A national dialogue should commence as soon as possible over this issue of disputed or unclear property rights.⁵³³ The absence of a credible system for resolving property disputes and enforcing contracts will inflame conflict, especially when ethnic cleansing forced one group out and another took possession, or if unequal access to land was an issue that motivated the conflict. Ambiguity can also deter investors when potential investments involve land-intensive projects in areas where outstanding claims still persist. Resolution systems should not exclude customary laws that are already in place or alternative forums (e.g., local government or traditional institutions) that may be able to help manage conflicts within or between groups. These can resolve disputes that do not require a full court proceeding.⁵³⁴ For more on property dispute resolution, see Section 10.7.10.

532. USAID, “Accelerating the Transition,” 2008.

533. USAID, “Guide to Economic Growth,” 2009.

534. Michael Bhatia and Jonathan Goodhand, *Profit and Poverty: Aid, Livelihoods and Conflict in Afghanistan* (London: Overseas Development Institute Humanitarian Policy Group, 2003).

9.5.27 Focus on laws to combat organized crime and other illicit economic activity. Laws that seek to combat predatory economic actors must be backed up by the means to investigate, prosecute, and convict those actors. This is a tall order. Laws should prevent money-laundering activity and provide ways for financial institutions and actors to report suspicious activity. Create a legal and administrative system to monitor and adjudicate such activity and seize assets when enforcing financial transaction laws. Legal safeguards should prevent predatory actors from capturing public entities when they are privatized. A transparency framework is needed to enable public posting of public property, bids and tenders for buying the property, identity of purchasers, financing of sales, and codicils on use of the property (the right of resale, restriction on use of assets) to ensure that sales are compliant with the transparency regime. The framework should also require public disclosure of transfers with the book and market values of the assets being transferred and the buyer of those assets. Also, state regulations and enforcement mechanisms are needed for enabling internal enterprise governance, maintaining relations with state entities, and reporting financial status and operations.

9.5.28 Engage the private sector on advocacy for policies and regulatory reform. Include the broader society in dialogue on policies and regulatory reform to achieve buy-in for economic recovery. But be cautious with regard to some business owners, who may have obtained their power and status during the conflict as a result of rent-seeking or predatory behavior. A public-private forum for dialogue on policies and regulations could benefit the private sector and jumpstart economic growth.⁵³⁵

9.6 Necessary Condition: Control Over the Illicit Economy and Economic-Based Threats to Peace

9.6.1 What is control over the illicit economy and economic-based threats to peace? Why is it a necessary condition?

Control over the illicit economy and economic-based threats to peace is a condition in which predatory economic actors are prevented from perpetuating conflict or hindering good governance and economic development, while the formal economy is strengthened to boost the legitimacy of the host nation government. One of the biggest economic threats to peace arises from the political-economic nexus, where resources acquired from illegal trafficking, smuggling, extortion, and hijacking of state and private enterprises are used to acquire and maintain both formal and informal power. The actors involved this economy may use coercion, terror, intelligence activities, and paramilitary operations to threaten the peace process. Allowing them to operate can hamper prospects for good governance and peace by promoting violence against civilians when acquiring control over assets, or exploiting and capturing trade networks and remittances.⁵³⁶

535. USAID, "Accelerating the Transition," 2008.

536. Karen Ballentine and Heiko Nitzschke, "The Political Economy of Civil War and Conflict Transformation," in *Transforming War Economies: Dilemmas and Challenges, No. 3 in Dialogue Series* (Berlin, Germany: Berghof Research Center for Constructive Conflict Management, 2006). Hereafter: Ballentine/Nitzschke, "Political Economy," 2006.

9.6.2 Guidance for Control Over the Illicit Economy and Economic-Based Threats to Peace

9.6.3 *Approach: Control Over Illicit Economic Activity*

During and after violent conflict, illicit economic activity will likely be pervasive and diverse and may include both benign and predatory actors. Gaining control over these activities requires addressing the problem on many different levels, including severing the nexus between political power and ill-gotten wealth, eliminating economic incentives for continued conflict, and cracking down on criminal trades that violate human rights and contribute to instability. There is also an illegal informal economy that ordinary citizens may resort to as a means of survival during violent conflict. While it may not present a threat to peace, it may be so broad that it threatens government legitimacy and badly needed sources of revenue.

9.6.4 *Understand the different economic channels that emerge from violent conflict.*

Prolonged violent conflict can fragment economic markets into several channels. While market fragmentation is broken down in many different ways, it is addressed in this manual to include four main elements: (1) the official or formal economy that is controlled or supervised by the government and the three following elements of the illicit economy, (2) the informal economy that citizens resort to as a means of survival during violent conflict, (3) the war economy that directly fuels conflict, and (4) the black economy, involving serious crimes and criminal networks that violate human rights and may directly or indirectly prolong the conflict. The lines between these groups are not always distinct—actors may operate across them, making it a complex challenge to address. The illicit elements of the economy are addressed in further detail below.

See Gap/Challenge: Section 9.10.3, Managing the informal sector without hurting ordinary citizens.

9.6.5 *Understand the legacy of the war economy and its effects on stabilization and reconstruction.* War economies finance conflict in many ways, primarily through violent control over assets and resources. Warring factions often gain control over certain industries or networks and use them to transport military supplies or to generate funding that directly fuels violence. This control can also threaten peace, undermine the legal economy, and enable predatory relationships.⁵³⁷ Key characteristics of a war economy are the following:⁵³⁸

- A criminalized political economy where political power is derived from access to illicit sources of revenue
- The destruction of the formal economy and the growth of black markets
- Extortion and violence against civilians to seize control over high-value assets (such as oil, diamonds, and timber), trade networks, remittances, and labor
- Presence of networks linking transnational organized crime, corrupt government officials, extralegal intelligence entities, spoilers, and external and internal terrorist organizations.

9.6.6 *Prioritize the identification and disruption of finance networks of local power brokers, insurgent groups, transnational organized crime, and terrorist organizations.*⁵³⁹

537. JICA, "Handbook for Transition Assistance," 2006.

538. Ballentine/Nitzschke, "Political Economy," 2006.

539. USAID, "Economic Governance in War Torn Economies," 2004. Covey/Dziedzic/Hawley, *Quest for a*

During violent conflict, many sophisticated crime networks often emerge for the trafficking of narcotics, humans, weapons, or lootable natural resources. These serious crimes make up what is broadly referred to in this manual as the black economy and often result in violence and serious violations of human rights. While many of these hostile economic activities may have existed in some form prior to the conflict, the actors who initiate them often exploit the security vacuum that follows violent conflict and expand their trades into the formal economy that are difficult to dismantle. These networks are also often linked to corrupt political leaders, who use the illicit revenue to sustain political power.⁵⁴⁰ This political-economic nexus constitutes a pervasive incentive and a driving mechanism for violent conflict. These networks should be broken up through aggressive law enforcement. States that are captured by a political-criminal elite can create an environment in which peace settlements seldom prosper. Predatory economic activities can corrupt governance and cripple the economic environment, making it impossible for legitimate business and foreign investors to operate. The integrity of the revenue stream that allows essential state services to be provided must also be protected for the political economy to be sustainable. These and other spoilers are also addressed in Section 6.5.10.

See Gap/Challenge: Section 9.10.1, Political-economic nexus.

9.6.7 Consider the consequences of aggressively curbing the informal economy. Violent conflict can severely weaken the official economy through corruption, inefficiencies, and falling revenue, which can increase the cost of doing business in this sector.⁵⁴¹ This reality often drives entrepreneurs to establish informal or parallel channels of commerce that may be illegal but represent the de facto economy during conflict. Because other normal distribution systems will have been disrupted, many ordinary citizens will rely on the informal economy for goods and services.⁵⁴² Any strategy to curb the informal economy, therefore, should avoid harm to ordinary entrepreneurs and should seek to leverage the economic activities that have emerged as the people's innovative and spontaneous response to difficult times.⁵⁴³ But encouraging people to participate in the formal economy is still essential to promote a base of taxpayers who have a stake in the country's future and enjoy benefits of good governance.⁵⁴⁴ Encourage integration of the informal market structures by making formal channels more accessible, affordable, and nurturing for entrepreneurs. Transform financial instruments to better accommodate the informal sector, through microfinance programs, trade credits, and extension services.⁵⁴⁵

9.6.8 Understand the consequences of predatory local actors in managing economic recovery programs. Safeguards against this should include real-time oversight, audits, and payroll mechanisms that limit infiltration and corruption.⁵⁴⁶ An important decision is whether to retain existing civil servants who have engaged in corruption in the past.

Viable Peace, 2005.

540. Gilpin, "Conflict-Sensitive Macroeconomic Growth," 2009.

541. Ibid.

542. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

543. Hernando DeSoto, *The Other Path: The Invisible Revolution in the Third World* (New York: Harper & Row, 1989).

544. Mendelson Forman/Mashatt, "Employment Generation," 2007.

545. Gilpin, "Conflict-Sensitive Macroeconomic Growth," 2009.

546. Mendelson Forman/Mashatt, "Employment Generation," 2007.

Retention may be attractive because the individuals have the skills to run the programs, but doing so may also pose great risks of destabilizing corruption.

9.6.9 Recognize that the public sector can be a major source of corruption.⁵⁴⁷ Corruption is the misuse of entrusted power for private gain and is a major challenge in these environments. Spoilers often develop ties to the government during conflict and entrench their power by putting supporters on government payrolls.⁵⁴⁸ This is distinct from low-level officials, who partake in petty corruption by looking the other way in enforcing business regulations in exchange for payments. Bribes are often attractive for civil servants because their salaries are low. Corruption undermines public confidence in the political system, impedes the development of strong political leadership and hampers economic growth by distorting competition and market conditions. Mitigating the harmful effects of corruption can involve developing and implementing anti-corruption laws, public education campaigns, and civil society watchdog organizations to pressure the state for good economic governance. Regular and adequate payment of civil service workers is a priority.

9.6.10 Deal with the harmful use of remittances. During violent conflict, remittances serve multiple purposes, making them difficult to address. Remittances often constitute a major source of livelihood security for many conflict-affected countries; provide a safety net for communities; and have been invested in social infrastructure, services, and income. At the same time, remittances are also often used to provide weapons and material support to violent groups. These dual purposes make remittances very difficult to address. Tracking and control of these flows is also very difficult because they flow into the country through informal channels. Improving the channeling of remittances to competitive industries that can help economically marginalized parts of population is an unmet challenge.⁵⁴⁹

See Gap/Challenge: Section 9.10.2, Monitoring diaspora remittances.

9.6.11 Approach: Management of Natural Resource Wealth

Natural resources include renewable and nonrenewable assets such as minerals, oil and gas, land, forestry, marine resources, and water. They can also include illegal commodities such as poppy and coca. Often, the battle for control over natural resources is a cause of violent conflict to begin with. Effectively managing the wealth derived from these resources involves equitably distributing the money to benefit the population, rather than corrupt individuals who are able to siphon the money into their own pockets. Doing so requires establishing the laws, institutions, and capacity to manage wealth in a transparent and accountable manner. Efforts must be made to avoid “resource curses,” which include corruption, economic instability, inequitable distribution, and control of resource wealth and areas. These curses undermine the sustainability of peace and long-term economic growth. But when natural resource wealth is used effectively, it can jumpstart revenue generation and have a positive effect on economic recovery. Natural resource wealth management is also discussed in Section 8.6.25.

547. Covey/Dziedzic/Hawley, *Quest for a Viable Peace*, 2005.

548. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

549. USAID, “Accelerating the Transition,” 2008.

9.6.12 Understand the context before designing a strategy to manage natural resources.⁵⁵⁰

These investigations should center on issues that are unique to the case.⁵⁵¹ The assessment should include the following:⁵⁵²

- An examination of the conditions of resources. What resources exist? How is resource wealth monetized and controlled?
- An assessment of the role of resource wealth in the war economy and the connections with government officials and violent spoilers.
- An assessment of how much control the government has over natural resource wealth and areas, including facilities (pipelines, oilfields, mines, airstrips for exporting minerals, etc.).
- A gap analysis of good resource revenue management systems (e.g., transparency, accountability, budget controls to handle volatility).
- Requirements for a stable, transparent, and accountable system for letting concessions.
- Identification of actual or potential subnational conflicts over revenue allocation.
- Identification of relevant work already being undertaken by international economic institutions.

9.6.13 Prevent control over natural resources, resource-rich areas, and relevant facilities by predatory actors.

Ensuring that legitimate actors have full access to these areas is key to management of natural resources for the benefit of the population. International actors should help the host nation government to establish financial controls for ensuring that revenue is spent in proper budgetary channels. Setting up national funds for revenue deposits from natural resources have been somewhat successful, as well as certification schemes for natural resources. Setting these systems up rapidly is best to prevent political leaders from entrenching their power.⁵⁵³

9.6.14 Draw from past approaches for improving the management of resource wealth and cutting off financing for hostile actors.

Solutions include a mix of carrots and sticks aimed at influencing state behavior and building civil society capacity to pressure its government for better management of natural resources.⁵⁵⁴ Sanctions are a means to drain support from states or violent groups that use natural resources to fuel conflict. Interdiction seeks to intercept illicit commodities in transit that drive conflict. The Extractive Industries Transparency Initiative is a voluntary measure that seeks to enhance transparency in natural resource management and collaboration among government, donors, and civil society. The Kimberley Diamond Certification Regime, which shuts out violent actors from the market, and the Publish What You Pay campaign are other well-known programs that have sought to encourage good management of resource wealth. Civil

550. United Nations Environment Programme, *From Conflict to Peacebuilding: The Role of Natural Resources and the Environment*, 2009. Hereafter: UNEP, *Role of Natural Resources*, 2009.

551. Some available resources include U.S. government agencies like the Energy Information Administration, U.S. Geological Service, USAID, and the State Department, as well as the World Bank and IMF; UN agencies such as UNDP; NGOs active in natural resource wealth management such as Global Witness, Human Rights Watch; resource companies; and country specialists and experts such as the U.S. National Defense University's Africa Center for Strategic Studies.

552. Shankleman, "Managing Natural Resource Wealth," 2006.

553. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

554. Shankleman, "Managing Natural Resource Wealth," 2006.

society can also help curtail corruption in natural resource management by collecting information on illegal resource exploitation and related government corruption.⁵⁵⁵

9.6.15 Strengthen governance practices to improve natural resource wealth management.⁵⁵⁶

The destabilizing effects of corruption related to natural resource wealth must be tackled at all levels of government. Proper natural resource wealth management depends on governance that is participatory and has a transparent and accountable system of revenue and spending. It also relies on solid corporate governance within an environment of government regulatory structures that promote good behavior. This requires confronting vested interests, involving civil society, and deploying specialized staff trained in following the path of illicit money.

9.6.16 Maximize participation from all players to ensure effective management. This includes participation of extractive industries, their bankers, the international financial institutions, regional organizations, international donors, and civil society. A problem in the past has been getting commercial banks and some states to cooperate in international efforts to restrict business with governments that are not transparent or accountable in their natural resource management. Coordination among financial institutions, governments, and international law enforcement agencies should address the linkages between money laundering, corruption, international crime, and sometimes terrorist financing.⁵⁵⁷ Successful management of resources also requires strong political leadership and a media sector and civil society willing to pressure the government for good governance.⁵⁵⁸ The natural resource issue should also be addressed in peace agreements, DDR programs, and peacekeeping mandates.⁵⁵⁹ Since World War II, resource management mechanisms have been addressed in fewer than 25 percent of peace agreements for conflicts involving natural resources.⁵⁶⁰

See Gap/Challenge: Section 9.10.5, Addressing economic factors in the peace agreement.

9.6.17 Approach: Reintegration of Ex-Combatants⁵⁶¹

Reintegration is a social and economic process in which ex-combatants return to community life and engage in livelihood alternatives to violence.⁵⁶² Ex-combatants can present an economic-based threat to peace if they are not successfully reintegrated into the social and economic fabric of society. Integrating ex-combatants into civilian life gives them a stake in the peace and reduces the likelihood that they will turn to insurgent or criminal activity to support themselves if they cannot find gainful employment. Reintegration activities include creating micro-enterprises, providing education and training, and preparing communities to receive ex-combatants.⁵⁶³ Reintegration is attached to the DDR process, but in reality it requires the attention, resources, and expertise of a very specific set of social and economic actors. It is a big gap for peacebuilders. See Section 6.7.14 for more on reintegration.

See Trade-off: Section 9.9.5, Employment opportunities for ex-combatants vs. women and minorities.

555. Ballentine/Nitzschke, "Political Economy," 2006.

556. Shankleman, "Managing Natural Resource Wealth," 2006.

557. Ballentine/Nitzschke, "Political Economy," 2006.

558. Shankleman, "Managing Natural Resource Wealth," 2006. United Nations Expert Group, *Natural Resources and Conflict in Africa: Transforming a Peace Liability into a Peace Asset*, 2006.

559. UNEP, "Role of Natural Resources," 2009.

560. Ibid.

561. U.S. Army, *FM 3-07*, 2008.

562. United Nations Secretary-General, *Note to the General Assembly, A/C.5/59/31*, 2005.

563. UN DDR, *Integrated DDR*, 2006.

9.6.18 Assess the social and economic situation to identify the best options for reintegrating ex-combatants.⁵⁶⁴ To make sound economic decisions, it is imperative to answer: What are the development opportunities? What is the capacity for economic absorption and what does the labor market look like? What is the local demand for goods and services? What is the condition of key economic infrastructure, such as access to markets or the availability of communications? It is critical to ensure that education and training, micro-credit services, and other business development services match the demands of the economy in question.⁵⁶⁵ Good employment options for ex-combatants will often engage them in strong, competitive, and profitable pursuits so they can contribute to economic growth.⁵⁶⁶ Additionally, it is important to understand the social services and institutions that are available, such as trauma and abuse support services and disability rehabilitation services.

9.6.19 Be sure to address the needs of communities receiving ex-combatants.⁵⁶⁷ It may be difficult to get communities to accept ex-combatants, especially perpetrators of atrocities. Most will have little to offer by way of education, employment, or training. Most soldiers are traumatized by their experience and could resort to criminal activities, rather than making solid contributions to communities.⁵⁶⁸ To quell trepidation, address the needs of the communities that will receive ex-combatants and communicate the goals and importance of the process. Successful reintegration depends on the support of communities, families, local leaders, and women's and youth groups. Encourage these groups to get involved in planning for the return of ex-combatants. Implement a strong public information campaign to spread awareness about the goals of reintegration. Consider funding a period of community service when ex-combatants settle in an area to promote their acceptance.

9.7 Necessary Condition: Market Economy Sustainability

9.7.1 What is market economy sustainability? Why is it a necessary condition?

A sustainable market-based economy leverages the power of markets to stimulate economic growth and reverse the negative effects of violent conflict.⁵⁶⁹ The revitalization of a market economy involves restoring the flow of goods and services within the country and across the border, through infrastructure, private sector, human capital, and financial sector development. In most cases, violent conflict will have caused production, consumption, and wealth to plummet. This slows goods and capital to a halt, keeping people from accessing much-needed food and basic necessities and developing their business. A sustainable market-based economy (1) facilitates equitable movement of goods and services, (2) creates a rewards-based meritocracy, and (3) focuses on efficiency and ultimately connections to global markets.

9.7.2 Guidance for Market Economy Sustainability

564. USAID, "Accelerating the Transition," 2008.

565. UN DDR, "Integrated DDR," 2006.

566. Mendelson Forman/Mashatt, "Employment Generation," 2007.

567. European Union, Concept for DDR, 2006.

568. UN DDR, "Integrated DDR," 2006.

569. United States Agency for International Development, *Market Development in Crisis-Affected Environments: Emerging Lessons for Achieving Pro-Poor Economic Reconstruction*, 2007. Hereafter: USAID, "Market Development," 2007.

9.7.3 Approach: Infrastructure Development

This section refers primarily to economic infrastructure: transportation (roads, bridges, rail lines), water works, electric power, telecommunications, oil and gas pipelines, government/public administration buildings, and other facilities required for an industrial economy to function. Infrastructure is vital for social, economic, physical and political cohesion.⁵⁷⁰ During violent conflict or through looting in its aftermath, infrastructure is often severely damaged or destroyed. Without physical infrastructure, access remains restricted among suppliers, service providers, and consumers, which poses a major constraint on economic development.⁵⁷¹

9.7.4 Establish infrastructure priorities according to broader strategic imperatives.⁵⁷²

In prioritizing infrastructure investments, remember that all investment projects are part of a larger reform package that should support the national strategic approach to development. Limited resources require that all investment decisions be made with this broader context in mind. Consider social, economic, and political factors in prioritizing investments, including group-based economic disparities that may have been integral to the conflict. The sequencing of investments should also make sense—reconstructing ports, for example, should not be done until the transportation systems leading to those ports are repaired. Refrain from building too many schools before there is a plan for trained teachers, materials, curriculum, and building maintenance that are required for a school to function.

9.7.5 Consider social, political, and environmental impacts in designing infrastructure projects. As in all economic recovery initiatives, the designers of infrastructure projects must always consider first and foremost the impact of their work on political stability and the potential to exacerbate conflict between different ethnic or religious groups. Infrastructure projects can have immense implications for migration and resettlement, the use of land, the environment, and perceptions of inequity.⁵⁷³ Infrastructure projects can often be used to promote peaceful relations by cultivating mutual interests among different groups in society and encouraging intercommunal cooperation. Divided communities that have made a commitment to support the peace process should be considered priorities for investment in infrastructure. Consider collateral issues presented with schools, including gender discrimination, inability to pay school fees, or decisions to send children to work rather than school. Other aspects of community-based development and reconciliation are discussed in Section 10.8.

9.7.6 Prioritize power, roads, ports, and telecommunications. Power is a precondition for formal economic development. Roads and waterways are essential for linking the rural economy to the urban market. City streets are vital when the private sector grows and begins to invest more heavily in vehicles, resulting in traffic congestion.⁵⁷⁴ Seaports and airports are critical for the movement of goods and people. Telecommunications is also a priority because social, economic, and political recovery depends on

570. JICA, "Handbook for Transition Assistance," 2006.

571. Infrastructure often includes social infrastructure, which refers to public institutions, schools, health facilities, post offices, and libraries. Some of these institutions are addressed in Section 10, Social Well-Being.

572. JICA, "Handbook for Transition Assistance," 2006.

573. JICA, "Handbook for Transition Assistance," 2006.

574. Collier, "Post-Conflict Recovery," 2007.

communications.⁵⁷⁵

9.7.7 Protect infrastructure to ensure peace and economic growth. Critical infrastructure is often a strategic target during or after conflict for people who seek to disrupt the peace process or instill fear. Police or military are often deployed to protect the infrastructure. Since transportation is the artery of the economy, it should receive priority protection. This includes roads, bridges, ports, and airports that have immense strategic value for enabling the flow of goods and people. See Section 6.8.9 for more on the protection of infrastructure.

9.7.8 Focus on infrastructure management, not just infrastructure itself. Much attention has been paid to the physical rehabilitation or construction of infrastructure, but it is just as important to strengthen the institutions responsible for managing and maintaining the infrastructure once it is established. These institutions include those that manage electricity companies; the road networks; the rail system, if it exists; and air, land, and seaports. Building institutional capacity is typically achieved by training staff and establishing mechanisms for corporate governance, management, and basic administration capabilities.⁵⁷⁶ The host nation population will be responsible for maintaining the systems, so their capacity will be the one that matters.

9.7.9 Rebuild only what should be rebuilt. Refrain from simply reconstructing the services that were destroyed during the conflict. Many practices before and during the conflict were designed for a few people to exploit wealth for their own gain, rather than for the benefit of the country. There may be pressures from certain groups or individuals to preserve these models, but careful assessments should identify which services will actually enhance economic growth. The equitable distribution of goods and services should guide careful consideration for longer-term structural changes.⁵⁷⁷ See also Section 8.5.11 for a discussion on equitable service delivery.

9.7.10 Recognize the wider benefits of infrastructure repair beyond its physical value.⁵⁷⁸ These benefits include demonstrating visible benefits of peace and quantifiable progress relatively quickly. Infrastructure development is also a key source of employment. Better roads reduce travel time and costs, which encourages farmers to travel to the market and produce more. Improved water supplies promote hygiene and reduce health problems, while improved irrigation increases agricultural productivity. Always think about these catalytic impacts when deciding what investments to make. Use infrastructure projects to strengthen administrative capacity and promote reconciliation by having former adversaries work side by side toward mutual community goals. See Section 10.8.12 for more on using infrastructure projects to benefit reconciliation.

575. Antonio Carvalho and Samia Melhem, *Attracting Investment in Post-Conflict Countries: The Importance of Telecommunications*, (Washington, D.C.: World Bank, 2005).

576. USAID, "Guide to Economic Growth," 2009. JICA, "Handbook for Transition Assistance," 2006.

577. USAID, "Guide to Economic Growth," 2009.

578. JICA, "Handbook for Transition Assistance," 2006.

9.7.11 Approach: Private Sector Development

The private sector is very diverse and can include everyone from farmers and micro-entrepreneurs to domestic manufacturing companies and multinational enterprises.⁵⁷⁹ A thriving private sector can provide numerous jobs for the population, serve as the main source of tax revenue, and enable the country to reduce its dependency on international assistance. Nurturing a healthy private sector requires that the enterprising class of individuals and firms have a means for saving money, have access to credit and financial services, have access to infrastructure, and have confidence in property rights. Perhaps most importantly, entrepreneurs need a predictable regulatory environment that enables them to pursue rational business plans.

9.7.12 Look to local investment and resources; don't wait for foreign investment.⁵⁸⁰ There is no question that foreign direct investment (FDI) brings much-needed assets into the country, including entrepreneurship, management, skills, and top-notch technology. But in the immediate aftermath of violent conflict, it is neither practical nor realistic to rely on this source of investment. Generally, FDI may not begin to flow until political, economic, and social risks are reduced and a level of predictability and stability restored. In the meantime, the host nation population should focus on domestic investments, including remittances from the diaspora.⁵⁸¹ Remittances sometimes make up a large bulk of domestic resources in the emergency phase, which can be invested in critical projects. The host nation government will also rely on international credit and technical assistance in these phases.

9.7.13 Provide access to immediate credit and financial services for micro, small, and medium enterprises. Providing people with access to loans for their small and medium enterprises is critical to jumpstarting economic activity and creating jobs. While loans are often available for large government reconstruction projects, they are less readily available for grassroots projects led by self-employed entrepreneurs or those working as part of small or medium enterprises. Many informal lending arrangements at the microlevel begin in refugee camps or on the streets as informal contracts between two parties.⁵⁸² But developing microcredit programs and institutions can get people together to exchange experiences, build capacity, and repair social capital.⁵⁸³ Microfinance is also key to promoting private sector activities by providing access to savings, insurance money transfers, and other banking needs of the population. Microfinance programs should target groups most affected by the conflict, including displaced persons, returning refugees, ex-combatants, and women.⁵⁸⁴ Strategies should go beyond the provision of credit to include systems for accrediting microfinance suppliers and monitoring and measuring impact.⁵⁸⁵
See Gap/Challenge: Section 9.10.4, Microfinance and effective intermediation.

579. United Nations Development Program, *The Role of Private Sector Development in Post-Conflict Economic Recovery*, 2007. Hereafter: UNDP, "Private Sector Development," 2007.

580. USAID, "Guide to Economic Growth," 2009. OECD, "Congo," 2003.

581. UNDP, "Private Sector Development," 2007.

582. Mendelson Forman/Mashatt, "Employment Generation," 2007.

583. International Labor Organization and United Nations High Commissioner on Refugees, *Micro-finance in Post-Conflict Situations: Towards Guiding Principles for Action*, 1999. Hereafter: ILO/UNHCR, *Micro-finance*, 1999.

584. Kathleen Kuehnast, "Innovative Approaches to Microfinance in Post-Conflict Situations: Bosnia Local Initiatives Project," 2001.

585. ILO/UNHCR, "Micro-finance," 1999.

9.7.14 Create an enabling environment that lowers risks, promotes business activity, and attracts FDI.⁵⁸⁶ There are two great hindrances to doing business in these environments: uncertainty about the rules of the game (laws and regulations) and the government's inability to enforce these rules fairly and impartially. Any increase in business activity will depend on an increase in the stability and predictability of the business environment in these regards. Before investing in a project, business owners and managers want to know that their properties will not be seized and that their contracts will be upheld. Other deterrent factors for investment include corruption, insecurity, and poor infrastructure.⁵⁸⁷ Mitigating these concerns will require undertaking difficult economic reforms, setting up a foreign investment code, and demonstrating that disputes over property rights can be resolved efficiently through dispute resolution mechanisms. A legal framework of economic laws and regulations is needed to evenly enforce business and trade regulations to ensure equitable compliance with taxes, licensing restrictions, and customs duties, etc.⁵⁸⁸

9.7.15 Leverage key markets as economic opportunities. The jobs available in relief operations can begin to create skills and services that could be useful for more sustainable industries. For example, a program that teaches women to make grass mats for refugee shelters could also train women in basket weaving to cater to handicrafts markets.⁵⁸⁹ Other examples include training local blacksmiths to craft fuel-efficient stoves used in refugee camps as well as agricultural tools, supporting local carpenters to supply school benches and desks, and supporting local tailors to supply school uniforms. These opportunities are often identified through a value chain analysis that helps focus attention on what markets to leverage.

9.7.16 Maximize the peacebuilding benefits of private sector activity. The marketing of some products may emphasize the experience of conflict and current living conditions of the producers. The success of Rwandan coffee in the past decade illustrates this phenomenon. The Rwandan coffee industry's official Web site prominently features a section on "Rebuilding and Reconciliation," refers to the country's recent genocide, and indicates that the development of the coffee industry is bringing "hope for a better future."⁵⁹⁰ Such marketing has helped Rwandan coffee producers to benefit even as global coffee markets have constricted over the last few years.⁵⁹¹ Additionally, the industry has become a force for economic integration between Hutus and Tutsis through cross-employment and collaboration in joint coffee, contributing to social cohesion and minimizing risks of a return to conflict.

9.7.17 Approach: Human Capital Development

Human capital refers to the stock of skills and knowledge embodied in a population of an economy.⁵⁹² Violent conflict depletes human capital through death, disability, trauma,

586. USAID, "Guide to Economic Growth," 2009. Mendelson Forman/Mashatt, "Employment Generation," 2007.

587. UNDP, "Private Sector Development," 2007.

588. USAID, "Guide to Economic Growth," 2009.

589. USAID, "Accelerating the Transition," 2008.

590. Coffee Rwanda, "Coffee Rwanda," <http://www.coffeerwanda.com/coffee.html>, accessed June 22, 2009.

591. Carter Dougherty, "Rwanda Savors the Rewards of Coffee," *The New York Times*, 2004.

592. See human capital entry in Deardorff's Glossary of International Economics, <http://www-personal.umich.edu/~alandear/glossary/h.html>, accessed June 22, 2009.

displacement, and migration of skilled workers. Even prior to the conflict, many countries suffer from an endemic lack of education, training and opportunities. Restoring human capital will require diverse training programs to account for all kinds of groups, including demobilized combatants, disabled persons, women, and children, as well as for entire communities. See Section 10.6 for more on the development of education.

9.7.18 Give all a stake in the peace process, including the most vulnerable. Inclusiveness and equity should be the aim when designing training and vocational programs. Focus on key political and social constituencies that require the most assistance, such as the poor, women, veterans, and demobilized soldiers. Finding ways to empower youth through human capital development is also critical as some have primarily been involved in violent conflict and will not have had access to education or skills training. Training for youth should also be integrated with remedial education.⁵⁹³

See Gap/Challenge: Section 10.10.5, Youth in recovery efforts.

9.7.19 Establish a means for collecting labor market data as the basis for human capital development. Human capital development programs need to be dynamic to respond to changes in the market. Collection of labor market data is essential for planning and should also be continuous thereafter, in communities, among public and private employers, in training programs, and in demobilization camps.⁵⁹⁴ It should include past and present data on life and peace skills of the population, vocational training, small and micro-enterprise development, and labor-intensive infrastructure works. The information allows the government to identify broad trends in labor supply and demand and see shifts in employment opportunities and demand for skills across the country. It can also help with the evaluation of program effectiveness.

9.7.20 Do not neglect the need to impart “life skills.” Conflicts result in a dearth of skills for work and in “life skills” as well. Life skills include the personal capacity to adjust socially in society and the work place, reconcile tensions, and come to terms with the conflict. Life skills training should always be included in education programs⁵⁹⁵ and be delivered in schoolhouses, demobilization camps, career centers, and community settings. The programs should be inclusive, innovative, practical, personal, and flexible so they can be tailored for individuals. Life skills are key to improving sustainable employment.

9.7.21 Begin training and education on the job and look to long-term educational capacity. Training for operational skills in the immediate aftermath of conflict may be done on the job, such as processing business licenses or managing a road project. Longer-term educational investments will be necessary to sustain economic growth. Doing this will require developing a true professional class of macroeconomic analysts and policy-makers trained in graduate-level programs in-country or abroad. Operational training in areas like treasury operations or tax administration has proven successful, but development of monetary and fiscal analysts has been more challenging because of the requirement for formal education in economics and policy analysis. Professional caliber

593. Johanna Mendelson Forman, “Achieving Socioeconomic Well-Being in Postconflict Settings,” *The Washington Quarterly*, Autumn 2002. Hereafter: Mendelson Forman, “Achieving Socioeconomic Well-Being,” 2002.

594. International Labour Organisation, *Local Economic Development: Operational Guidelines*, 1997. Hereafter: ILO, *Local Economic Development*, 1997.

595. Ibid.

will differ from case to case, which will impact the level of training needed.⁵⁹⁶

9.7.22 Approach: Financial Sector Development

The financial sector refers to the system of commercial banks and lending institutions supervised by an independent central bank that provide much-needed credit to businesses and individuals in the aftermath of conflict. Enabling access to microcredit and the ability to perform financial transactions beyond the simple cash and barter economy is critical for economic growth.⁵⁹⁷ Two major functions of banks are to provide a trusted institution for people to deposit financial savings and to provide a means to pay for goods and services to promote commerce.

9.7.23 Be prepared for a banking system that is severely debilitated. During violent conflict, the central bank and many commercial banks may have ceased to function. Politically directed loans at concessionary interest rates and insider loans to managers or relatives of managers may have occurred frequently. Operating systems, internal controls, and management information will also be degraded or outdated. Reforming the banking sector should begin with the development of a central bank. It will also involve transforming systems of insolvent and poorly managed banks into a structure capable of mobilizing resources and evaluating loans. Making the transition has posed many problems. The goal is to ensure that banks are able to provide effective intermediation between lenders and customers.

9.7.24 Seek to rebuild trust in the banking system. After violent conflict, most people have lost trust in the banking system and will be reluctant to convert their savings into the local currency. The majority of the population will likely rely on informal credit networks during the conflict. But without deposits, the banking system will have trouble playing a greater role in financing economic recovery. The central bank will have to regulate the banking system effectively to build confidence in the banking system once again.⁵⁹⁸

9.7.25 Understand that microfinance can contribute to growth, but alone it is not a substitute for reconstituting the core banking capacity of the country. Microfinance institutions usually form only a small part of the financial sector in relation to the commercial banking system, but they are valuable tools for creating jobs and promoting growth after violent conflict. While they are not substitutes for rebuilding the banking system, these institutions are useful socioeconomic development tools for poor populations without access to the formal banking sector. Microcredit programs are also positive ways to generate income for women and other marginalized groups and can build social capital by promoting interaction and exchange. These programs allow small groups, not individuals, to be collectively responsible for loan repayment and.⁵⁹⁹ Microfinance projects should be undertaken within the context of a wider strategy for the broader financial sector.

596. USAID, "Economic Governance in War Torn Economies," 2004.

597. USAID, "Guide to Economic Growth," 2009.

598. Haughton, "Reconstruction of War-Torn Economies," 2002.

599. UNDP/USAID, "First Steps," 2007.

9.8 Necessary Condition: Employment Generation

9.8.1 What is employment generation? Why is it a necessary condition?

Creating jobs is a keystone of any economic recovery program. Many activities can fall under the rubric of job creation, including immediate short-term opportunities that yield quick impact, or the development of more enduring livelihoods in the civil service or private sector. It is important to distinguish between these different activities, recognizing that sustainability and long-term impact should be duly considered in implementing any employment generation program. Providing jobs is vital on many levels. Politically, employment opportunities give the population a stake in the peace process by providing young men and women with alternatives to violence. Economically, employment provides income to poor families, revives domestic demand for goods and services, and stimulates overall growth. Socially, employment can also promote social healing, encourage the return of displaced persons, and improve social welfare in the long run.

9.8.2 Guidance for Employment Generation

9.8.3 Approach: Quick Impact

Developing enduring livelihoods is vital for long-term peace and economic growth, but getting concrete results can take many years. In the emergency phases of economic recovery, the most immediate imperative is getting people back to work and getting money flowing, even if the work is only temporary. The point of emergency phase economic recovery is to get labor and capital back to work quickly to show visible benefits of peace.⁶⁰⁰

9.8.4 Generate positive results by focusing on public works projects.⁶⁰¹ Public works projects are effective ways to generate a lot of employment quickly while demonstrating progress that benefits communities. Job opportunities can include small-scale food- or cash-for-work projects, such as cleaning up public places, repairing roads and facilities, or installing generators. Be sure to consult with the host nation population on these efforts and to communicate to the population that this is a partnership effort between international actors and the host nation population.

9.8.5 Keep sustainability in mind, but avoid placing undue emphasis on it in the very early stages of recovery.⁶⁰² Jobs that favor quick impact cannot substitute for long-term livelihood creation and should be viewed as much as possible through a lens of long-term sustainability.⁶⁰³ Any short-term job creation program should be established in parallel with sustainable employment programs. However, focusing too heavily on the sustainability of economic activities while ignoring short-term imperatives is a mistake. When implemented well, quick impact projects can be effective in employing large numbers of people in the immediate aftermath of violent conflict.

600. UNDPKO, *Principles and Guidelines*, 2008. United Kingdom Stabilisation Unit, "Helping Countries Recover," 2008. Hereafter: UK Stabilisation Unit, "Helping Countries Recover," 2008. USAID, "Guide to Economic Growth," 2009.

601. Mendelson Forman/Mashatt, "Employment Generation," 2007.

602. Mendelson Forman, "Achieving Socioeconomic Well-Being," 2002. Robert Perito, *The U.S. Experience with Provincial Reconstruction Teams in Afghanistan: Lessons Identified* (Washington, D.C.: U.S. Institute of Peace, 2005).

603. Mendelson Forman/Mashatt, "Employment Generation," 2007.

See Trade-off: Section 9.9.7, Meeting urgent needs for jobs vs. focusing on sustainable employment.

9.8.6 Recognize the potential impact of the international presence on economic distortions.⁶⁰⁴ One distortion often occurs in the domestic labor, housing, and retail markets in the early recovery phases. International actors often pay high salaries for expatriates, international civil servants, domestic translators, and drivers, while increasing the demand for local housing and services attuned to foreign tastes and salaries. This creates tough competition for the host nation government to attract skilled professionals for public service.⁶⁰⁵ The resulting disparity between the wealth of international actors and the economic hardships of the host nation population risks increasing friction, particularly between the country's urban centers and the rest of the country. To mitigate these effects, international actors should determine appropriate wage rates for local staff, making them comparable to local government pay scales. Progressive income taxes are another way to reduce the attractiveness of working for the international community versus the host nation government.⁶⁰⁶

9.8.7 Approach: Agricultural Rehabilitation

In most societies emerging from conflict, the agricultural sector provides the primary source of employment. Rehabilitating the agricultural sector and enabling landowners to grow the right crops, process them, and get them to market are key steps in economic recovery. During violent conflict, many farmers will have reduced their production of export crops, while increasing subsistence production. Governments may sometimes resort to heavy taxes on agricultural exports to finance their military spending.

9.8.8 Provide broad assistance in rehabilitating the agricultural sector. While most of the focus will be in rural farming, sometimes rehabilitation will include food processing and distribution, which would also involve work in urban areas. Assistance providers should understand what crops and livestock are staples for local diets and cash crops, and also when the crop cycles are in order to design employment programs that do not disrupt planting or harvests.⁶⁰⁷ Public sector capacity is also necessary to regulate agricultural policy, including the establishment of a ministry of agriculture and development of farmers organizations. Immediate rehabilitation tasks should include the following:

- Mine clearance of farmlands
- Provision of seeds, tools and livestock
- Repair of infrastructure, including processing and transport equipment, irrigation and drainage facilities, construction of water supplies, and improvement of roads and local market facilities
- Development of trade relations to increase linkages among producers, processors, and markets
- Improvement of access to credit

604. IPA, "Economic Priorities," 2002. USAID, "Economic Governance in War Torn Economies," 2004.

605. JICA, "Handbook for Transition Assistance," 2006.

606. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007. USAID, "Guide to Economic Growth," 2009.

607. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

- Provision of training in livestock management and crop productivity
- Land reform.

9.8.9 Avoid disincentivizing local farming through relief operations. In responding to humanitarian emergencies, governments and relief organizations flood supplies of food into the country. This drives down local food prices by decreasing demand for locally produced food. Donor assessments should identify potential effects of relief operations to ensure that food aid does not adversely impact domestic agriculture or marketing.⁶⁰⁸

9.8.10 Approach: Livelihood Development

The development of sustainable livelihoods is critical to providing a predictable flow of income to families and build skills and capacity in the labor force. In these environments, most opportunities for long-term employment will be concentrated in the civil service, private sector, and agriculture.

9.8.11 Recruit capable, accountable individuals for a lean and effective civil service.

Running government operations will require individuals with the capacity to contribute managerial, technical, and administrative talent. The civil service can be a strong source for new employment if sustained over the long term by adequate revenue generation. There will be pressures to rapidly recruit people for the civil service, but be careful not to create a bloated force.⁶⁰⁹ Place a premium on professionalism, accountability, political independence, and a public service ethos. There also may be pressure to introduce ex-combatants into the civil service as a long-term job, but doing so may jeopardize the integrity of the service if they support certain parties.⁶¹⁰

9.8.12 Focus on agriculture, construction and service sectors, which will often provide the bulk of job opportunities.⁶¹¹ After violent conflict, the labor force typically lacks workers with advanced education, training, or marketable skills, which were lost through flight of professionals, injury, or death. Because of this, the agriculture, construction, and service (hotels, transport, logistics) sectors will be enormous draws for the labor market, as they do not require highly specialized skills, and demand for these industries will likely be high. Focus on these areas in the employment generation strategy to maximize the number of jobs for the population.

9.8.13 Pay special attention to women in micro-enterprise or vocational training.⁶¹² During violent conflict, many women may have become heads of large households. They will have acquired critical skills to adapt to food shortages and become micro-entrepreneurs in the informal economy. This reality is too often overlooked in livelihood development strategies. Women are left out of vocational training opportunities and face unequal access to credit, assets, and technologies, forcing them to find jobs in more traditional sectors with limited potential.⁶¹³ Supporting women economically, however, can help promote the welfare of their children. Women in this respect are major catalysts for peace.

608. Ibid.

609. WB, "Rebuilding the Civil Service," 2002.

610. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

611. USAID, "Guide to Economic Growth," 2009. IPA, "Economic Priorities," 2002. UNDP/USAID, "First Steps," 2007.

612. Mendelson Forman/Mashatt, "Employment Generation," 2007.

613. ILO, "Local Economic Development," 1997.

9.9 Trade-offs

9.9.1 Economic efficiency vs. political stability.⁶¹⁴ Because S&R missions are not development as usual, political considerations will typically trump economic ones. This means that the best approach may not be the most optimal or efficient from an economic perspective. It follows that the success of economic programming should be measured not purely by its economic criteria as it would be in a normal development scenario, but whether it supports peace and reconciliation.

9.9.2 Sophistication vs. simplicity in the income tax system. In the emergency phases, there will likely be weak capacity for administering tax policies. Rather than trying to create a sophisticated income tax system for the entire population, it may be wise to install an interim regime for simpler taxes, like excise or sales taxes, which are easier to raise.⁶¹⁵

9.9.3 Creating donor trust funds vs. strengthening the host nation budget process. Many international actors prefer to manage their assistance funds, but doing so can create a bifurcation between host nation and donor-funded budget systems. Once accountability structures are functioning with adequate safeguards, spending should be integrated into a comprehensive state public investment program and capital budget to strengthen the government capacity and ensure host nation input in the budgetary process.⁶¹⁶

9.9.4 Macroeconomic reforms vs. political stability.⁶¹⁷ While there may be an urge to quickly stabilize the economy, doing so too aggressively can have negative impacts on political stability. Cutting subsidies to public sector enterprises with bloated work forces, for example, can create a pool of unemployed and disgruntled recruits for groups seeking to disrupt the peace process. All economic stability measures must be accompanied by a careful assessment of the political situation in the country.⁶¹⁸ Ultimately, the solution is a matter of the degree to which macroeconomic stability is imposed.

9.9.5 Employment opportunities for ex-combatants vs. women and minorities. In war-torn economies, employment opportunities will be scarce. Prioritizing jobs for ex-combatants may mitigate violence, but it can also seem unjust to others who may be more qualified, particularly those who may have been systematically discriminated against before or during the conflict. This is a difficult trade-off, but the imperatives of maintaining a fragile peace may require prioritizing ex-combatants, at least in the near term.⁶¹⁹

9.9.6 Public vs. private sector in public utility services. Having politicians manage local utilities may help build internal management and governance capacity. But doing so also risks preserving corrupt, pre-conflict arrangements that jeopardize quality service and perpetuate discriminatory practices. The private sector, on the other hand, would likely be more effective in reestablishing services and customer relationships. A careful balance

614. OECD, "Congo," 2003.

615. IPA, "Economic Priorities," 2002.

616. UNDP/USAID, "First Steps," 2007.

617. Scott Feil, "Building Better Foundations: Security in Post-Conflict Reconstruction," *The Washington Quarterly*, Autumn 2002.

618. IPA, "Economic Priorities," 2002.

619. Dobbins/Jones/Crane/Cole DeGrasse, *Beginner's Guide*, 2007.

must be struck between these two approaches. Some utilities may benefit from a hybrid public-private relationship, where a private concession is issued to operate a facility.⁶²⁰

9.9.7 Meeting urgent needs for jobs vs. focusing on sustainable employment. In the emergency phases, there is often an urgent need to put people to work. Doing so often involves jobs that may produce tangible results quickly, but do not necessarily develop sustainable incomes or livelihoods. Balancing these two imperatives has proven to be a critical challenge.

9.10 Gaps and Challenges

9.10.1 Political-economic nexus. Connections between those in power and ill-gotten wealth often develop during conflict and continue in its aftermath. This nexus can be detrimental to the legitimacy of the government and can undermine sustainable peace and development by diverting vital resources from the people. An integrated political-economic security strategy is an essential mechanism for dealing with this nexus.

9.10.2 Monitoring diaspora remittances. During violent conflict, diaspora remittances serve both positive and negative purposes, making them difficult to address. While they may constitute a major source of livelihood for many, remittances are also used to fuel conflict. Tracking the money is difficult because they often flow into the country through informal channels. Keeping remittances from fueling conflict is an unmet challenge.

9.10.3 Managing the informal sector without hurting ordinary citizens. Managing the informal economy is very difficult because its composition is often very diverse after lengthy periods of violent conflict. While it can include destabilizing criminal elements such as drug or human trafficking, the informal sector tends to comprise most of the economic activity that ordinary people resorted to as a means of survival in a war-torn economy.

9.10.4 Microfinance and effective intermediation. Loans are often readily available for large government reconstruction projects, while micro-entrepreneurs and small businesses find it difficult to access capital to finance smaller grassroots-level projects. Providing credit to these individuals and businesses is a challenge that can yield tremendous peace-building and social fabric-building effects in war-torn countries.

9.10.5 Addressing economic factors in the peace agreement. Peace negotiations typically focus on security and justice issues, while leaving out economic dimensions of conflict. Peace agreements are pivotal moments and should include provisions that establish clear benchmarks for sharing and managing resources, especially if there is a criminalized political economy where corruption or exploitation determines access to political power. When designed well, peace agreements can serve as a foundational roadmap for transforming conflict and providing a foundation for state building.

9.10.6 Public finance management. Transparent and accountable management of public resources is a problem that consistently plagues societies emerging from conflict. Corrupt financial management practices are a common feature in these governments and deprive the state of resources that are badly needed to fund major economic and social development projects. More attention must be paid to establishing proper means for oversight of finance management.

620. USAID, "Guide to Economic Growth," 2009.