

Private Sector Development in Reintegration and Reconstruction Programmes

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Preface

The German Federal Ministry for Economic Cooperation and Development (BMZ) has commissioned a project for the design of innovative tools for private sector development to be incorporated in the assistance programmes of partner countries. Within this broader objective, the specific purpose of this paper is to elaborate an integrated approach for private sector development in post-conflict reconstruction and reintegration programmes.

Economic development in post-conflict environments is a broad subject. Not least due to the facts that no two conflicts are entirely the same and there remains considerable scope for what constitutes an appropriate economic development strategy under normal circumstances. As a result, this paper is at serious risk from the 'one size fits all' criticism that haunts much of development policy making. Bearing this in mind, as these fields are increasingly scrutinized in a more systematic way, some patterns and emerging. Readers are expected to exercise their own best judgement in deciding if various parts of the analysis conform to their own experience and circumstances.

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1. Introduction

This paper develops a framework for private sector promotion in post-conflict environments. It begins by analysing the evidence that draws the link between economic development and conflict. This is followed by an encapsulation of current trends in economic development. The purpose is to establish the broader range of private sector development options under normal circumstances. Post-conflict conditions are then examined to narrow down the field of potential interventions. This includes a brief survey on current approaches to emergency aid, reconstruction and reintegration programmes. The resulting framework for private sector development incorporates the intersection of short-term reconstruction processes and long-term economic development strategies.

The suggested framework is built around four pillars and an overarching component. The pillars include:

- Strengthening private sector participation in infrastructure reconstruction;
- Specific interventions for private sector development according to the country context;
- Improving the financial sector; and,
- Strengthening vocational skills training.

The overarching component involves immediate post-conflict measures to improve local investment climates.

2. Background and Theory

This section lays the foundation for a conceptual framework for supporting private sector development in post-conflict reintegration and reconstruction programmes. The foundation is built on four areas of analysis. It begins by exploring the evidence on the root causes and patterns of conflict. This is followed by a review of current approaches to private sector development under normal circumstances. The effects of conflict from macro, meso and micro perspectives are introduced to begin refining an approach to private sector development under post-conflict conditions. The section concludes with summary of current donor approaches to reintegration and reconstruction.

2.1 Sources of Conflict

A recent report by the researchers for the World Bank introduced the concept of a 'conflict trap' into the development lexicon. It describes a vicious cycle where poverty leads to conflict and, in turn, conflict sustains poverty. This was based on the observation that sixteen out of twenty of the poorest countries in the world have experienced violent conflict in the recent years. The strength of the trap is such that in any ten year period, nearly half of all conflicts were the result of failed peace initiatives and relapses into previous patterns of violence.¹

The researchers concluded that, beyond all other considerations, economic factors are most important in determining the likelihood of violent conflict. The study examined civil wars between 1965 and 1999 and concluded that the risk of violent conflict is primarily related to three economic determinants. These include the level of per capita income, the rate of economic growth and the structure of the economy. Doubling the level of income reduces the risk of conflict by half; a one percent rise in economic growth results in a one per cent decline in the risk of conflict; and, reducing dependence on natural resource exports significantly reduces the risk of conflict.² Other characteristics, such as ethnic and religious differences, political rights and colonial history did not register the same degree of significance. They suggest that ethnic or other grievances are not the *cause* of war. Ethnic and other potential grievances are generally well contained without violence in middle-income countries with diversified and growing economies - to the extent that they are generally safer than homogeneous societies. Conversely, however, conflict is often more easily organized through the rhetoric of ethnic and other grievances in the context of poverty, stagnation and valuable natural resources.^{3 4}

¹ Collier et al, (2003), *Breaking the Conflict Trap: Civil War and Development Policy*, World Bank Policy Research Report No. 26121, World Bank, Washington, D.C.

² Collier and Hoeffler (2005), *Resource Rents, Governance and Conflict*, Journal of Conflict Resolution, Vol. 49, No.4, August 2005.

³ Collier (2004), *Development and Conflict*, Centre for the Study of African Economies, Department of Economics, Oxford University. Mimeograph, October 1, 2004.

There has, however, been some criticism of the World Bank research. Critics have focused on the methodology and analysis. The methodology has been questioned because of a measure of subjectivity in the indicators. The analysis has been criticised as taking a rather leap from correlation to causation.⁵ These critiques unleashed considerable debate as to whether greed or grievance constituted the more frequent root cause of conflict. While the debate has not been definitively concluded, a middle ground settlement in the debate may be found in the observation that causes can vary according to the duration of conflict. This means that the justification for starting a conflict may be different from the reasons for continuing after a prolonged period. Over time violent attacks and retaliation can increase the intensity of perceived grievances. Similarly, changes in political leadership over time and the de-capitalising effects of prolonged conflict can lead to the entrenchment of war economies where the political and economic power of competing factions depends on the continuation of conflict.⁶

Despite these critiques, a particularly important thesis of the World Bank research has withstood scrutiny. This relates to the opportunity costs for armed insurrection in poor countries. The argument is that what really matters is the ability of insurgents to mobilise effectively. In this regard, the costs of mobilising are lower in stagnant or narrow economies where large numbers of unemployed youths and lootable natural resources exist. This view was reinforced in the recent influential UN Report of the UN High-level Panel on Threats, Challenges and Change, *A more secure world: Our shared responsibility*.⁷ The report clearly promotes the concept of an inextricable link between development and security.

In summary, while there may be some question about the *relative* importance of economic factors in explaining the root causes of various conflict, there is little doubt that poor economic conditions are correlated with the propensity for violent conflict. This understanding forms the basis for supporting economic growth through private sector development in post-conflict environments.

2.2 Current Economic Development Strategies

The simple truth is that economists have yet to concur on what might constitute a perfect economic development strategy. While there are many sources of disagreement, one of the more common debates centres on the role and extent of state intervention in markets. There

⁴ Mousseau et al (2003), "How the Wealth of Nations Conditions the Liberal Peace", *European Journal of International Relations*, Vol. 9(2), 277-314.

⁵ Klem, B. (2004), "A Commentary on the World Bank Report 'Breaking the Conflict Trap'", Working Paper 25, Netherlands Institute of International Relations 'Clingendael', Conflict Research Unit, January, 2004.

⁶ Cornwell, R. (2002) "Where to From Here" in Scarcity and Surfeit, *The Ecology of Africa's Conflict*, Edited by Jeremy Lind and Kathryn Sturman, Institute of Security Studies, South Africa, pp.357-365

⁷ United Nations(2004) *A more secure world: Our shared responsibility*, Report of the Secretary General's High Level Panel on Threats, Challenge and Change, United Nations Department of Public Information, New York.

is, however, some consensus on the importance of the investment climate in shaping the incentives of businesses to invest, create employment, and expand. On these grounds, improvements in the investment climate are seen as drivers of economic growth and key elements in poverty reduction strategies.^{8 9}

The ‘*World Development Report 2005: A better business climate for everyone*’ published by the World Bank, suggests that investment climate strategies can be built around a number of key concepts. First, the goal should be to create a better investment climate for all types of firms. Types of firms can include small, large, local, foreign, low-tech, high-tech, and so on. Second, efforts need to go beyond just reducing costs for businesses and address government policy risks and barriers to competition. Third, governments should recognize that there may be a huge gap between formal policies and implementation. This requires tackling the deeper sources of policy failures, such as corruption, to ensure that policy interventions fit local conditions. Fourth, while there may be no perfect economic development strategy, governments should consistently address key constraints in ways that promote investor confidence. Finally, beyond the broader objective of creating a better investment climate for the benefit of all firms, specific interventions to promote private sector development should carefully identify areas for special policy treatment, be wary of tendencies for rent-seeking when privileges are granted, and be cautiously examined from a cost-efficiency perspective.

Improvements in the investment climate can be achieved by focussing on the appropriate policy frameworks in basic areas such as stability and security, regulation and taxation, finance and infrastructure, and labour markets.¹⁰ The main elements of these basic policy frameworks and prevailing principles for specific interventions for private sector promotion are:

- ***Stability and Security:*** Strategies to strengthen stability and security are drawn from the relationship between the security of property rights and higher levels of economic growth. There are greater incentives to open new businesses and invest more when property rights are protected. On the other hand, firms in insecure environments require higher returns on investment to compensate for higher levels of risk. Higher levels of risk result in lower volumes of investment and correspondingly lower levels of economic growth.¹¹ Various measures to strengthen stability and security include, among others, verifying rights to land and other property; facilitating contract enforcement; reducing crime and corruption; and, ending uncompensated expropriation of property.

⁸ This section draws heavily on the investment climate approach suggested in the World Development Report 2005: A better business climate for everyone. Washington, D.C.: World Bank.

⁹ World Bank (2005). Pro-Poor growth in the 1990s Lessons and Insights from 14 Countries. Washington, D.C.: World Bank.

¹⁰ World Bank (2004). World Development Report 2005: A better investment climate for everyone, Washington, D.C.: World Bank.

¹¹ Keefer, P. (2004). “A Review of the Political Economy of Governance: From Property Rights to Voice”, Policy Research Working Paper No. 3315, Washington, D.C.: World Bank.

- *Regulation and Taxation:* Government regulation and taxation have a direct and obvious impact on business investment decisions. Regulations are required to address market failures. Taxes are necessary to finance public services that cannot be efficiently or equitably provided through private markets. There is, unfortunately a crippling degree of similarity in how these functions are carried out in developing economies. Informality, poor administration and corruption reduce government revenues. For businesses, they increase uncertainty, costs and distort competition. Standard measures to strengthen regulatory and tax administration capacity include, among others: streamlining procedures and simplifying tax codes, curbing discretion of government officials, increasing the autonomy of tax authorities, broadening regulatory consultations and the tax base, and exploiting information technologies to reduce delays and corruption.¹²
- *Finance and Infrastructure:* Firms of all sizes require adequate financial services and public infrastructure to expand and be competitive in a global economy. Restricted access to financial services limits the ability of businesses to create jobs and invest in new production techniques. Poor quality transportation, energy, and communications systems increase costs and reduce the profitability and volume of investment. Standard measures, among others, to improve financial systems have focused on strengthening prudential supervision and regulatory capacity of central banks; resolving information problems by strengthening creditor rights and establishing credit bureaus; introducing greater competition through non-bank financial intermediaries; and, encouraging microfinance. In addition to introducing competition and improved regulation, standard measures to improve infrastructure have included contracting-out services and improving funding mechanisms.^{13 14}
- *Labour Markets:* Strategies to improve *labour markets* need to balance the interests of workers in job-security and the requirements of business for an increasingly skilled workforce and flexibility in employment practices. A skilled workforce is often a necessary precondition for firms to invest in technologies to enhance the quality and competitiveness of products and services. Similarly, flexible employment practices can be essential for adjusting production schedules to respond to seasonal or rapidly changing market demands. Measures to achieve this balance in labour markets have included, among others: increasing investment and introducing competition in education and training services; statutory reform which also accounts for the interests of the often larger informal sector; and social insurance policies that facilitate greater employment mobility.¹⁵

¹² Op Cit.

¹³ Ibid.

¹⁴ Addison et al. (2005), "Reconstructing and Reforming the Financial System in Conflict and 'Post-Conflict' Economies", Journal of development Studies, Vol.41, No.4, May 2005, 703-718.

¹⁵ Op Cit.

- *Private Sector Development Interventions:* The policy frameworks outlined above have been formulated with the objective of creating a better investment climate for all firms. Achieving these conditions may require deep societal changes and considerable time. Under these conditions, governments are often under pressure to respond with specific interventions to address perceived market failures. Specific interventions often include policies and strategies to promote:
 - foreign direct investment
 - exports
 - specific industries
 - small or rural firms

Instruments may include, among others: market restrictions; tax or regulatory privileges; clustering or regional promotion strategies; subsidised credit and information based strategies. These may also involve activities such as entrepreneurship training for small business start-ups, promotion of non-financial business development services, and strengthening of business associational activity. Each of these instruments carries a set of costs and benefits that must be weighed carefully in relation to the specific context.¹⁶

This section has encapsulated current trends for strengthening the investment climate private sector development under 'normal' circumstances. They emphasise the importance of developing the appropriate policy frameworks and carefully considering specific interventions for private sector development to promote long-term economic growth. A long-term perspective, however, is frequently considered as a luxury in post conflict settings. The next sections provide a brief overview of conditions often faced in countries emerging from conflict. This includes an examination of political and economic conditions that may shape priorities and a summary of current donor responses to the challenges of reconstruction and reintegration.

2.3 Macro, Meso and Micro effects of Conflict

Violent conflict can have a devastating impact on social and economic relations. Initial levels of development and the duration, scope and intensity of hostilities all have a bearing on the scale of challenges faced by countries emerging from conflict. The variable effects are often observed from macro, meso, and micro social and economic perspectives.

At the **macro-level**, the demands of a war economy may have drastically reduced state capacity to provide even basic social and economic infrastructure. Democratic institutions and state authority, even if they existed in the first place, are likely to have been severely impaired. In many cases, inflation will have eroded confidence in national currencies. Furthermore, after peace agreements have been reached, there are often serious questions about how ex-combatants can be reintegrated into local communities and civilian life. As a

¹⁶ See Chapter 8: Selective Interventions in World Bank (2004). World Development Report 2005: A better investment climate for everyone, Washington, D.C.: World Bank.

result, immediate post-conflict periods are often characterised as precarious and chaotic transitions rather than agendas ordered to specific objectives and timetables.¹⁷ In response, significant levels of international assistance may be required to mediate the design of new political institutions, finance the reconstruction of social and economic infrastructure, and assist the transition to peaceful and sustainable livelihoods.

At the **meso-level**, sources of foreign investment and regional trade patterns may have been disrupted through the closure of borders and the severance of a variety of other economic relationships. The interests of formal and informal networks and organizations that profited and grew during the period of violent conflict often need to be challenged or accommodated.¹⁸ It may include addressing groups that profited from illegal activities such as smuggling or extortion and the more formal requirements of military demobilisation and reintegration.¹⁹

Finally, at the **micro-level**, in the immediate post-conflict period local populations are often destitute because skilled labour and capital have left the conflict zone in search of greater security. The resettlement and social reintegration of ex-combatants and impoverished returnees may take place against a backdrop of questions of land reform and limited employment and re-training opportunities in weak markets.²⁰

2.4 Current Approaches to Reintegration and Reconstruction

The overriding concern that emerges from each level is to maintain an often fragile peace and prevent an immediate relapse into violent conflict. In this regard, many post-conflict strategies focus on immediate concerns for the disarmament, demobilisation and reintegration of ex-combatants. The first two phases are readily distinguished by verifiable milestones to mark their achievement. In contrast, reintegration is both a social and economic process with an open time frame.

The main components of reintegration programmes often include: the formulation of national policy; support to regional implementation agencies; local level emergency aid; socio-economic profiling; transport to selected resettlement regions; discharge payments; reinsertion packages, reconstruction projects, employment promotion, and vocational training.²¹ The extent of local private sector involvement in each of these components can vary considerably according to local post-conflict capacities. Nonetheless, reconstruction projects, employment

¹⁷ Debiel and Terlinden (2005). *"Promoting Good Governance in Post-Conflict Societies"*, Discussion Paper, GTZ/ BMZ, Eschborn, Germany

¹⁸ Collier (2004).

¹⁹ International Alert (2004), *From War Economies to Peace Economies in the South Caucasus*, London, U.K.

²⁰ Gleichmann et al (2004), *Disarmament, Demobilisation and Reintegration: A Practical Field and Classroom Guide*

²¹ Ibid.

promotion and vocational training are the areas which usually witness the greatest level of private sector participation.

Throughout the 1990s, an increasing number of multilateral and bilateral development agencies have been called upon to intervene in post-conflict countries. The dominant approach to reintegration and reconstruction was that of a 'continuum' of interventions, moving from emergency relief activities to reconstruction and ultimately to development.²²

Increasing demand and experience has led a number of agencies to set up special facilities to respond more rapidly and flexibly to specific needs of different post-conflict settings. Reintegration and reconstruction programmes are often executed through large-scale cooperation among donor agencies, national and international non-government organisations and host governments. For example, cooperation may be organised through Consolidated Inter-Agency Appeals by the United Nations and/or through initiatives under the Post-Conflict Fund of the World Bank. Resources from a wide array of donors may be pooled and the specific technical expertise of organisations such as UNHCR, ILO and GTZ may be coordinated under the umbrella of national programmes.

Experience in several settings has led to the emergence of best practices for conflict-sensitive approaches to reintegration and reconstruction.²³ These include:

- Tailoring interventions in response to the detailed socio-economic needs assessments of ex-combatants and receiving communities;
- Building upon the existing self-help livelihood strategies of local communities;
- Building participation, transparency and accountability in the design, implementation and evaluation of programmes;
- Building capacity of government to assume long-term responsibility of local development processes

The World Bank reintegration and reconstruction programme in Eritrea and the UNDP/ILO PRODERE programme in Central America emphasised a number of these best practices. In Eritrea, the main components of the World Bank's economic reintegration programme focused on providing:

- Links between community needs for infrastructure rehabilitation and employment promotion for ex-combatants;
- Referral services for employment opportunities;

²² Becker (2003), "*Private Sector Development in (Post)-Conflict Situations - Experience by International Organizations*", Draft Report 15.04.2003, GTZ, Eschborn

²³ World Bank (2005), "*Conflict and Recovery in Aceh: An Assessment of Conflict Dynamics and Options for Supporting the Peace Process*", Social Development Notes, Conflict Prevention & Reconstruction, No. 22, August 2005.

- Skills training based on aptitude and self-selection; and
- Access to micro-enterprise support schemes.²⁴

In Central America, the UNDP/ILO PRODERE programme adopted a Local Economic Development (LED) strategy which emphasised a *non-discriminatory approach* to promoting human rights, building a consensus around development issues, facilitating the reintegration of returnees, restoring basic services in areas such as health, education and housing, and reactivating the local economy.

The LED approach aimed at employment creation and income generation through an optimal use of human and other resources in a determined geographical economic catchment area. Groups traditionally excluded from economic development processes were given the opportunity participate in the planning and the design of interventions. This involved the establishment of Local Economic Development Agencies as bottom-up participatory instruments to build consensus, tackle threats and exploit economic opportunities. Particular emphasis was placed on strengthening the capacity of local stakeholders to articulate their interests, plan and organize initiatives, and to link the local economy with national and global economies. The overall approach placed equal weighting on the process and output. In other words, broad participation was considered as essential for sustainable social and economic reintegration and reconstruction.²⁵

²⁴ OpCit.

²⁵ Becker (2003)

3. Conceptual Framework

Previous sections have examined the potential sources of conflict, private sector development under normal circumstances, the variable effects of conflict and current donor approaches to reintegration and construction. The challenge that emerges is to balance immediate concerns for security while laying the foundation for economic growth through private sector development. Reconstruction and reintegration programmes can be designed to support these simultaneous objectives through conflict-sensitive strategies. The main pillars of an integrated conceptual framework would include:

- Reconstructing social and economic infrastructure;
- Specific interventions to encourage private sector development;
- Promoting the financial sector; and
- Strengthening labour markets.

Within the category of specific interventions to promote private sector development, macro-level measures to improve post-conflict investment climates are suggested as the overarching component to integrate the individual pillars within an overall framework.

3.1 Reconstruction of Social and Economic Infrastructure

The private sector is invariably involved in the post-conflict reconstruction of social and economic infrastructure. How that involvement is organized can have lasting effects on the foundations for sustainable economic growth. It can have an immediate impact on employment levels and influence the long-run competitiveness of firms of all sizes. There are, however, significant differences to consider in the design of small and large scale infrastructure reconstruction programmes.

It is important to distinguish between the approaches to reconstruction of large and small scale infrastructure because of the potentially different effects on short and long-term employment levels. Programmes for small-scale infrastructure projects are often favoured for their potential to create immediate employment opportunities at local levels in post-conflict settings. How these programmes may be organized is discussed below. In contrast, large scale infrastructure reconstruction programmes in key economic areas such as energy, transportation, and communications are often mired in controversy and delays. In the midst of coping with the challenges of reintegrating demobilised combatants into civilian life, governments may be understandably reluctant to proceed with restructuring programmes that might add to already swollen ranks of unemployed persons. At the same time, donors or private sector investors may be averse to finance sector investments without credible commitments for restructuring. The trade-off for these delays in the wider economy is, unfortunately, lower long-term levels of firm productivity.

The importance of **large-scale economic infrastructure** for the development of small and medium enterprises clearly emerges from many of the investment climate assessments of post-conflict economies.²⁶ These assessments are based on firm-level surveys designed to identify the key investment constraints. Basic economic infrastructure *always* scores high on the priority list because managers recognize the direct impact on the bottom-line competitiveness and profitability of their business.

While the political and financial challenges for the reconstruction of large-scale infrastructure may be daunting, there is much that can be done to prepare the groundwork during the immediate post-conflict stage. This includes, among others,

- Organizing sector working groups to begin addressing the concerns of potential donors and private sector investors;
- Formulating socially-responsible retrenchment programmes;
- Organizing private sector associations to build political constituencies;
- Developing tender documents;
- Conceiving linkage programs to promote partnerships between foreign and local investors; and often
- Significant legal and sector policy reforms.

All of these activities require time, learning, and often intense negotiation. These preparations are generally not costly and, if properly coordinated, the bulk of investment can be timed to coincide with the increasing levels of absorptive capacity that usually emerge around three to four years after the end of conflict.²⁷

In contrast, **small-scale infrastructure programmes** are often a favourite vehicle to assist in immediate post-conflict social and economic reintegration processes.²⁸ Their popularity stems from their ability to address the usually obvious need for reconstructing education, health and other local infrastructure while also providing a source of short-term employment. They can have a direct impact on poverty levels during the transition period, and if managed properly, they can also be a catalyst for skills development (VT), small and medium enterprise development (SME) while reducing the propensity for conflict at local levels.

Key considerations in the design of post-conflict small-scale infrastructure programmes emerge from assessments of local private sector and government capacity. The private sector may lack the depth of competition, practical experience, technical skills, or sufficient capital to respond to the challenges of reconstruction. Local governments, in addition to

²⁶ See <http://www.ifc.org/ifcext/economics.nsf/content/IC-InvestmentClimateAssessments>

²⁷ Collier (2004).

²⁸ These programmes fall often called Quick Impact Projects or Micro-projects.

facing similar capacity constraints, also often lack credibility and may suffer from extensive levels of corruption in post-conflict environments. In this regard, the dual purposes of improving the government credibility and local the investment climate can be achieved when small-scale infrastructure programmes are implemented according to transparent and inclusive procedures.

Experience from a number of post-conflict settings illustrates that the process of selecting, administrating and implementing local infrastructure projects can be an intensely political undertaking, often with significant distributional consequences at the local level.²⁹ Which roads, water systems, or schools get rehabilitated can have an important impact on local business and family incomes. In the past, this has been often overlooked by small-scale infrastructure programmes in the post-conflict rush by donor agencies to achieve respectable volumes of rehabilitated facilities or jobs created. Ensuring that these potentially contestable decisions are conducted in a transparent manner can be essential for reducing the propensity for conflict within local communities. If designed and implemented according to procedures which emphasise participation, transparency and accountability, small-scale infrastructure programmes can be an equally important step toward reducing corruption, limiting opportunities for illegal expropriation by predatory government officials and, as such, can lead to improvements in local investment climate.³⁰

Promoting local participation in small-scale infrastructure projects has been a mainstay of many decentralization programmes since the 1980s. Research on these processes has shown that decisions made at local levels tend toward solutions that are more within existing local capacity to implement and maintain.³¹ This often results in procurement decisions that favour local businesses. However, in the immediate post-conflict period local communities are often divided and the private sector may lack significant competitive pressure. Divisions may result from the pressures of accepting refugees and local populations may have built up a deep mistrust of government structures. The lack of trust inherent to weak governance situations may require independent third parties to ensure that the goal of promoting local businesses is achieved without deepening community divisions.³²

In summary, post-conflict reconstruction of social and economic infrastructure serves two purposes. First, it can be used as a vehicle to create short-term employment opportunities during the fragile transition to peace. Small-scale infrastructure programmes can be designed to promote local businesses, increase the credibility of government structures, and

²⁹ Examples of donor-financed programmes that have followed this approach include the GTZ-FRCS Project based in Georgia and the ILO-PRODERE projects in El Salvador, Guatemala, and Nicaragua.

³⁰ This is based on the experience of the GTZ-FRCS Project.

³¹ Manor, J. (1999), *The Political Economy of Democratic Decentralization*. Washington, D.C.: World Bank

³² See Humphreys and Weinstein (2004), *WHAT THE FIGHTERS SAY. A Survey of Ex-Combatants in Sierra Leone, June-August 2003*, Interim Report: July 2004, PRIDE, Freetown. Their survey of more than 1,000 demobilised ex-combatants revealed high expectations among local populations for donors to compensate for weak governance conditions in Sierra Leone.

improve the local investment climate. Second, large-scale economic infrastructure programmes can, if properly timed and coordinated, make significant contributions to the long-term productivity of businesses. Given normal lead times and trends in absorptive capacity, preparations for large-scale infrastructure programmes should begin the immediate post-conflict period. However, the narrow development processes that gave rise to the original conflict often continue to constrain private sector participation in reintegration and reconstruction programmes. Addressing these challenges most often requires a combination of specific interventions, improving access to capital, and strengthening labour markets.

3.2 Specific Interventions to promote Private Sector Development

Each post-conflict setting requires a detailed needs assessment to determine the appropriate combination of support strategies and instruments to promote private sector participation in reintegration and reconstruction processes. This information provides the basis for the choices among micro-level strategies that focus on the promoting the competitiveness of individual firms; meso-level strategies that concentrate on needs of specific groups of businesses within a defined area, and broader macro-level strategies which address constraints faced by all businesses.

3.2.1 SME Promotion (Micro-level)

Micro-level interventions in post-conflict settings focus on improving the competitiveness of individual SMEs. This approach may be favoured when conflict has resulted in limited public or private meso-level partners to respond to immediate and urgent demands for employment alternatives. Following sections consider the wider array of available instruments, such as access to credit and qualified labour, to improve long-term individual SME competitiveness. Based on these parameters, this section considers the challenges of specific interventions which can have an *immediate* impact on the ability of SMEs to create employment. This includes a review of the instruments of financial subsidies and linkage programmes for SMEs in relation to employment promotion programmes.

When prolonged conflict has resulted in the collapse or severe constriction of credit facilities, **financial subsidies to SMEs**, in the form of grants or heavily subsidised credit, have been offered in exchange for promises **to create productive employment opportunities**. Financial subsidies may be used to purchase materials, equipment and/or pay salaries of newly employed people. While creating immediate employment opportunities, the approach often faces concerns over cost-effectiveness, rent-seeking, and sustainability.

Judging the viability of one business over another often requires intimate knowledge of local markets and an adequate assessment of individual reputations. This challenge and concerns over cost-effectiveness and rent-seeking can be at least partially addressed by adopting emerging best practices in employment fund management in post-conflict settings. Best

practices have focused on developing appropriate selection, monitoring and evaluation procedures based on principles of participation, transparency and accountability.³³

Application procedures and selection criteria should be well publicised. Application procedures must ensure that local government, private sector, and community representatives have true ownership over grant funding decisions. Getting this balance right can be a challenge in highly corrupt environments. Nonetheless, social pressure is often a more effective instrument than weak formal governance structures typical in post-conflict environments.³⁴ Selection criteria, where conditions permit, may favour existing businesses over start-ups. The experience gained by existing businesses tends toward greater sustainability.³⁵

Best practice in monitoring and evaluation of employment funds also stress the importance of well publicised criteria and wide reporting of results. Monitoring schedules should be coordinated with grant disbursement schedules and independence from programme administration is essential. In some circumstances, particularly where there are high levels of corruption and weak governance structures, independent expatriate managers for monitoring and evaluation may be required. Investment in on-going monitoring and evaluation procedures will pay dividends in three important ways. First, it will allow fund administration to concentrate on the critical function of timely disbursements. Second, savings will be generated through the earlier termination of non-performing grant agreements. Thirdly, and not least, enhanced transparency serves to rebuild trust and the investment climate in divided communities.

The influx international assistance during immediate post-conflict periods often results in increased rates economic growth. Financial subsidies can help SMEs to participate in the growth spurt associated with reconstruction. However, in many instances, additional capital is not necessarily the largest obstacle or only obstacle that SMEs must overcome. They may also lack information on opportunities and knowledge of how to compete for supply and reconstruction contracts. In these circumstances, **linkage programmes** can increase the competitiveness of small firms. Linkage programmes have been developed in a number of post-conflict settings, including countries such as Azerbaijan, El Salvador and Mozambique. They typically focus on:³⁶

- Improving technical and business skills to qualify SMEs for contracts in reconstruction and development programmes

³³ MacDonald (2002), "A Reflection on the Program for Reintegration of Demobilized Soldiers in Mozambique", Draft Report, GTZ, Eschborn.

³⁴ See MacDonald (2005), "Post-Conflict Reconstruction and Private Sector Development – Case Study – GTZ Project for Food Security, Regional Cooperation and Stability in the South Caucasus", GTZ, Eschborn.

³⁵ See MacDonald (2002) "A Reflection on the Program for Reintegration of Demobilized Soldiers in Mozambique", Draft Report, GTZ, Maputo. This assessment is based on employment promotion interventions in Mozambique where nearly 400 start-up and existing small businesses were supported with micro-grants to employ demobilised soldiers. Structured monitoring and evaluation revealed consistently more sustainable employment was achieved through support to existing businesses.

³⁶ See [http://www.ifc.org/ifcext/sme.nsf/Content/Linking SMEs to Investments](http://www.ifc.org/ifcext/sme.nsf/Content/Linking_SMEs_to_Investments)

- Facilitating access to finance
- Strengthening local supply and distribution networks

In addition to the challenges faced in administering financial subsidies, linkage programmes require extensive information and communications strategies to match the demands of buyers with the capacity of suppliers. The process can be simplified by developing common standards and procedures with donors and government for the procurement of reconstruction supplies and services. Depending on the availability of service providers, technical and business skill training may be offered to individual or groups of similar SMEs. Establishing access to credit SMEs can be supported by structuring supply and service contracts according to the needs of existing financial institutions. This may require various forms of loan guarantees. It should be noted, however, that the difficulties in distinguishing winners from losers and the personalised nature of support may result in high unit costs per job created under linkage programmes. These constraints are often cited as the justification for the meso and macro-level interventions described in the following sections.

3.2.2 Local and Regional Economic Development (Meso-Level)

Meso-level strategies typically concentrate on needs of specific groups of businesses within a defined area. As such, **Local and regional economic development (LRED)** strategies includes a broad range of instruments that may be effective in promoting the private sector in post-conflict environments. Field experience indicates potentially promising results for strategies that include:

- The establishment of local business development agencies;
- Sector promotion strategies and
- Regional trade initiatives.

Various experiments with commercial designs for **local development agencies** have been in recent years. The designs generally vary on the degree of public or private ownership. There is, however, some consistency in the services and patterns of operation. Services typically include:

- Entrepreneurship training;
- Market research;
- Business plan preparation;
- Business registration services;
- Facilitation of regional and international trade initiatives; and,
- Promotion of non-financial business development services.

With respect to patterns of operation, the need for donor subsidies is consistent, regardless of the degree of public or private ownership. There are initial indications, however, that supporting private economic development agencies may be more cost-effective and sustainable over the long-term than supporting public local development agencies in weak governance environments.³⁷

In most cases, local development agencies face a time consuming and costly process to develop or source technical capacity to support small businesses within their region. This in combination with weak demand for business development services in post-conflict markets warrants high subsidy levels, possibly including portions of capital and overhead, during the start-up phase of local development agencies. After the start-up phase, subsidy agreements should be structured on a declining fee for service basis. This allows donors agencies to measure effective market prices for various services and allows local development agencies sufficient time to adjust or abandon services in response to market demand.

It is also important to note that successful local development agencies invest considerable effort in marketing to donor institutions. They also recognize that their long-term success depends greatly on their ability to demonstrate an active local client base which supports some portion of operating costs during the lean times between donor agency funding programs.

Local economic development agencies can be instrumental in organizing core groups around potential **sector promotion strategies**. Sector promotion strategies focus on the comparative advantages a region has to offer. Detailed interventions may be based on value chain analysis or, depending on circumstances, also incorporate various aspects of linkage programmes. While introducing new technologies may be helpful, the largest stumbling block is often getting an alignment of interests between public and private actors to achieve full sector potential. Finally, the agriculture sector often receives emphasis in poverty stricken post-conflict environments. This emphasis may not necessarily result from a comparative advantage in agricultural production, but is more often in recognition of its central importance to income levels of the rural poor.

Conflict invariably disrupts regional trading patterns. Re-establishing economic links may play an important role in reducing the propensity for violence in conflict-prone border regions and contribute to the competitiveness of small businesses.³⁸ Nonetheless, **Regional trade initiatives**, particularly in the agriculture sector, should be considered carefully. Prices may fall when markets are open to cheap or subsidised products. Conversely, they may rise through access to new markets. These important and complex relationships dictate a need for extremely careful analysis of regional trade policies in post-conflict environments.

³⁷ This is based on preliminary evidence from the SIDA-financed local development agency in northern Mozambique and the experience of the GTZ-FRCS project in Armenia, Georgia and Azerbaijan.

³⁸ This is based on the experience of the GTZ-FRCS project in Armenia, Georgia and Azerbaijan.

3.2.3 Investment Climate (Macro-level)

Previous sections have briefly outlined numerous interventions and opportunities for private sector participation in post-conflict reconstruction processes. However, these suggestions have tended to gloss over the equally numerous obstacles which restrict the ability of the private sector to fulfil its role. Restoring a balanced perspective and integrating the strategies described in previous sections within an overall framework requires a return to the concepts of the **investment climate** presented in Section 2.2.

Without immediate improvements in the investment climate, the private sector is often restricted in participating in reconstruction processes. Studies have shown that there is often a sharp increase in donor funding following a peace agreement. However, when it can take more than a year to open a business or the financial system cannot provide sufficient working capital to satisfy local purchase orders, donors under pressure to make disbursements are more likely to turn to international suppliers and NGOs to undertake the bulk of post-conflict reconstruction. This can result in missing an important growth opportunity for many potential small and medium enterprises.

Timing is important in changing any cycle. Certain investment climate reforms, such as reducing red-tape or simplifying tax codes, may produce immediate results. However, on average, restoring broader investor confidence is likely to require addressing often deeply-rooted issues, such as corruption, judicial reform and other governance failures. These adjustments require persistence, some investment, and take time. These factors all argue strongly for timing investment climate reform to start sooner rather than later in post-conflict environments.

The Bulldozer Initiative in Bosnia and Herzegovina provides an illustration of how rapid improvements in the investment climate can be achieved in a post-conflict environment.³⁹ The initiative resulted in 50 investment climate reforms in 150 days. A bottom-up approach was used to mobilise the local business community to ‘bulldoze’ local barriers to investment. Grass-roots support was built through identifying specific impediments and proposing concrete legislative changes. Examples of reforms included lowering minimum capital requirements for limited liability companies, simplifying business registration procedures, and abolishing a host of antiquated business regulations.

A key tactic for building support for the overall reform strategy in Bosnia and Herzegovina involved a concerted media campaign. A central coordination unit provided local journalists with complete access to information on all sides of the debate on specific reforms. This entailed a continuous stream of press releases, formal and informal interviews, symbolic events, and press conferences. Hundreds of thousands of brochures, on various reform topics, were also distributed to the general public. In the end, the speed and practical orientation of reform encouraged the participation of the local business community and enhanced public awareness. This put pressure on politicians to enact reforms.

³⁹ Herzberg (2004), “Investment Climate Reform: Going the Last Mile, the Bulldozer Initiative in Bosnia and Herzegovina”, World Bank, Washington, D.C.

Finally, it should be noted that contextual factors may have had some bearing on the success of reform processes in Bosnia and Herzegovina. These include the special powers attributed the UN High Representative and some measure of receptivity on the part of local politicians. Also, surveys of local businesses revealed expectations that donors should assume a proactive role in convincing local government to undertake investment climate reforms.

In summary, narrow development and conflict is often rooted in deep economic problems which are manifested in the investment climate. The evidence suggests that it is possible and desirable to initiate investment climate reforms sooner rather than later in post conflict-environments. This can assist local private enterprises to profit and grow more from reconstruction processes and broaden the cycle of development before a relapse into conflict occurs. This shift in timing is important. The example from Bosnia and Herzegovina demonstrates the feasibility and promise of bottom-up approaches supported by public awareness campaigns to pressure politicians to enact reforms.

3.3 Strengthening Post-Conflict Financial Sectors

As with all areas of an economy, conflict has significant effects on financial systems. Among the more important effects, conflict will alter preferences for different types of assets and can have deep consequences for the governance of financial institutions. With regard to the preferences for different types of assets, the usual examples associated with conflict include conversions of bank deposits for precious metals or the choice of foreign over domestic currency. The degradation of the governance of financial institutions will often depend on the scope and intensity of conflict. In this respect, the descent into uncertainty, violent conflict and the breakdown of the rule of law is often accompanied by the looting of banking systems by managers, regulators and political elite.⁴⁰

Conflict increases risk and reduces the supply of capital for local private investment. At the same time, it is now well understood that broad-based private investment is necessary to break the cycles of narrow development that fail to reduce poverty and conflict.⁴¹ Restoring confidence, rebuilding and extending financial systems in the wake of prolonged conflict can be a complex task. It can encompass a wide range of activities including, among others, currency reform, reconstruction of central banks, recapitalisation of commercial banks, and significant regulatory reform.⁴² Within this scope of potential challenges, this section considers the important experience of extending microfinance services and strengthening financial sector in post-conflict settings.

⁴⁰ Addison et al. (2005), "Reconstructing and Reforming the Financial System in Conflict and 'Post-Conflict' Economies", *Journal of Development Studies*, Vol. 41, No. 4, May 2005

⁴¹ Addison et al. (2001), "Finance in Conflict and Reconstruction", Discussion Paper No.2001/44, World Institute for Development Economics Research (WIDER), United Nations University.

⁴² Op Cit.

The wider benefits of **microfinance** for poverty reduction are commonly accepted. However, the challenges of initiating or extending microfinance services in post-conflict environments are less well explored. Conventional perceptions are that security and the rule of law are among the prerequisites for establishing sustainable microfinance. Nonetheless, recent research challenges these myths and indicates the need for an expanded role for microfinance in post-conflict settings.

Since the mid-1990s, microfinance interventions have been implemented in several post-conflict countries including, among others: Afghanistan, Bosnia, Cambodia, Kosovo, Mozambique and Rwanda. On the basis of this experience, a number of studies now indicate that microfinance can serve as perhaps *one of the most efficient instruments* to support household incomes, self-employment and micro-enterprise formation during post-conflict reconstruction periods.^{43 44} Discussions on how microfinance in post-conflict environments differs from normal circumstances generally focus on the timing or preconditions for intervention and design considerations such as systems and procedures, technologies, type of implementing agency, and target groups.

The issue of when to begin microfinance interventions can be broken down into essential and preferred conditions.⁴⁵ Essential conditions include:

- A reasonable amount of security or stability of access;
- The re-emergence of some economic activity; and
- Some assurance that clients will remain in place long enough to recover loans.

Afghanistan provides an excellent illustration of meeting essential conditions for microfinance. By 2004, more than US\$25 million had been committed by various donors to a centrally-coordinated microfinance programme.⁴⁶

Preferred conditions for starting microfinance interventions in post-conflict environments are those which can make implementation easier, but have been proven to be not essential. Preferred conditions include:

- A functioning banking system;
- An absence of hyperinflation;

⁴³ Matul and Tsilikounas (2004), "Role of Microfinance in the Household Reconstruction Process in Bosnia And Herzegovina", *Journal of International Development*, Vol. 16, 429-466 (2004)

⁴⁴ Santos (2003), "Financing small, medium and micro enterprises in post-conflict situations Microfinance opportunities in the Democratic Republic of the Congo", Discussion Paper for the seminar "Public Private Partnership for the Development of the Democratic Republic of the Congo", Kinshasa, April 7, 2003, OECD Development Centre.

⁴⁵ Doyle (1998), "*Microfinance in the Wake of Conflict: Challenges and Opportunities*", Micro Enterprise Innovation Project, USAID.

⁴⁶ World Bank (2004), "*Afghanistan: Pioneering Donor Coordination for Microfinance*", accessed at <http://web.worldbank.org>

- A certain population density;
- Social capital;
- A skilled workforce; and,
- A favourable policy environment.⁴⁷

The evidence to support definitive best practices in design considerations such as systems and procedures, technologies, type of implementing agency, and target groups remains somewhat inconclusive due to substantial differences in many post-conflict environments. However, under the extraordinary assumption of all things being equal, certain tendencies can be identified.

This begins from the observation that most professional microfinance practitioners are rather consistently cold-blooded in viewing the sustainability of their interventions in bottom-line and business like terms. They invariably draw attention to the importance of well-trained staff operating according to tried and tested procedures and technologies developed under variable circumstances. These factors point to the distinct advantage of specialized international microfinance institutions in relation to multi-purpose local non-governmental organisations. The same practitioners have been quick to recommend that it is more effective and less risky to open programmes for mixed clientele rather than to target special groups. This not only reflects bottom-line concerns, but also avoids creating tension in conflict-affected communities.⁴⁸

With regard to specific lending technologies, individual lending appears to have achieved more success than group lending in post-conflict environments. This view is supported by limited results in targeting microfinance services to demobilised soldiers. This, of course, is subject to a number of variables. Targeting may be deemed to be a political imperative and group technologies or micro-grants administered through separate organisations may be a preferred strategy.⁴⁹

In summary, evidence suggests that microfinance can be an extremely effective instrument for promoting micro-enterprise formation during post-conflict periods. The limited number of essential conditions also indicate that microfinance can be initiated much sooner than is usually the case. Finally, specialized international microfinance institutions, due to tried and tested technologies, have distinct advantages over local multi-purpose non-governmental organisations in delivering sustainable financial services.

Microfinance can have an immediate and positive impact on poverty, self-employment and micro-enterprise formation in post-conflict situations. This alone, however, is unlikely to address the long-term credit requirements to ensure the broad growth of small and medium

⁴⁷ Op Cit.

⁴⁸ Op Cit.

⁴⁹ Gleichmann et al (2004)

enterprises. In many cases, this can only be accomplished through significant **financial sector reform**.

Banking systems in post-conflict environments may be in dire need of recapitalisation. However, even where capital is available, lending to SMEs may be inconsequential. Under these circumstances, SMEs will often find themselves entirely dependent on retained profits and informal credit such as foreign remittances for their investment finance. Nonetheless, re-establishing economic activity following conflict requires a banking system that can provide:

- efficient clearing of domestic and foreign payments,
- the use of deposit accounts by households and businesses, and
- loans for private investment

Reviving the banking system, however, is usually only part of wider systemic challenges such as reforming the legal framework to allow for a broader range of financial services and the introduction of a variety of governance measures to improve the enforcement of property rights.⁵⁰

The key question is where to begin. Strengthening prudential supervision and regulatory capacity of central banks is essential for building a stable financial system over the long-term. This, however, must usually be accompanied by broad governance measures mentioned above. If this is not politically feasible within the country context, in the short-term it may often be more effective to support interventions that promote greater competition in the financial system. This is likely to exert greater pressure on domestic financial institutions to improve the quality of their services and the introduction of non-financial intermediaries can lead to a broader range of financial services.⁵¹ This may require overcoming some entrenched interests within the existing banking sector and updating commercial regulations and laws to make leasing, insurance and other modern business practices more available.

As a final note, addressing systemic challenges in financial sectors is likely to require a high level of donor coordination and some measure of local political support. At the same time, the transition to peace is often accompanied by great expectations for change. Donors could do more to exploit this hope by *promoting financial sector policy reforms earlier in the post-conflict period* - before new coalitions emerge to block much needed financial market reforms.⁵²

⁵⁰ Addison et al. (2005)

⁵¹ World Bank (2001), *Finance for Growth: Policy Choices in a Volatile World*, Oxford: Oxford University Press for the World Bank.

⁵² By way of example, the donor working group for the financial sector was only established almost ten years after the peace agreement in Mozambique. Earlier and broader coordination might have been useful in averting a number of intervening banking sector scandals.

3.4 Strengthening Post-conflict Vocational Training

This section briefly explores the important role and relationship between vocational training and private sector development in reintegration and reconstruction programmes. While there may be differences depending on the scope and intensity of conflict, employment markets in many post-conflict settings often have limited potential, particularly in rural areas, to absorb large numbers of ex-combatants or returning refugees. Furthermore, particularly following prolonged periods of conflict, ex-combatants may have had little access to previous formal education or skills training. From a private sector perspective, vocational training enhances skills and productivity of the labour force. The local private sector may also be involved in the supply of toolkits, curriculum design, rehabilitation of training facilities, delivery of training programs, and benefit from employment promotion programmes.

Vocational training is often a central element in reintegration and reconstruction programmes. For example, in Sierra Leone, more than 80% of the 75,000 registered ex-combatants participated in vocational training designed to assist their reinsertion into local labour markets. The desire for obtaining new employment skills, training subsidies, and promises of toolkits played a significant role in achieving this participation rate.⁵³

Needs assessments and labour market studies generally mark the first steps toward establishing or rehabilitating vocational training programmes. Needs assessments measure the demand for various forms of training within specific target groups. In this regard, the World Bank and UNHCR have developed procedures for **socio-economic profiling** of returnees to enable tailor-made support programmes. Labour market studies provide an indication of the demand for specific skills by potential employers. The demand for training invariably exceeds the supply of formal sector employment. This leads to the requirement for candidate selection processes and the inclusion of basic entrepreneurship modules within training curriculum.

Selection processes are more likely to appropriately address the skills requirements of potential employers and lead to higher placement rates. Selection processes can be based on principles of self-selection, aptitude testing and, if they exist, on previous qualifications.^{54 55} Entrepreneurship training can assist trainees to formulate their own self-employment strategies.

Experience in Sierra Leone illustrates the concerns of ex-combatants in relation to vocational training programmes. While participants were generally satisfied with the overall results of reintegration, they also identified a clear set of priorities for improving the vocational training programmes. A representative survey of ex-combatants identified the need for:

- More support for finding jobs after training (54%);

⁵³ Humphreys, M. and J. M. Weinstein (2004) "WHAT THE FIGHTERS SAY: A Survey of Ex-Combatants in Sierra Leone, June-August 2003" Interim Report: July 2004, PRIDE, Freetown.

⁵⁴ This is based on the experience of the GTZ-FRCS project based in Georgia.

⁵⁵ See also Becker (2003).

- Longer periods of training (47%);
- Support to start small businesses (30%); and,
- Larger allowances (15%).⁵⁶

Formal sector **skills training** programmes may be supplemented by strategies to support informal skills development in post-conflict environments. Informal skills development programmes build on the concept of complementarity by supporting the way most people in developing countries acquire skills. This is through on-the-job or apprenticeship training. *On-the-job training* is often used in conjunction with small-scale infrastructure reconstruction programmes described in Section 3.3.1 and may contain a portion of formal course training. Support for *traditional apprenticeship training* programmes may need to be adapted for local customs.⁵⁷ Support for either approach may involve wage subsidies and, in the case of traditional apprenticeships, additional tools and equipment. Since traditional apprenticeships are often arranged through small informal businesses, the input of tools and equipment may also help to increase productivity and sustainability of the business.

There *may* also be a case under particular circumstances for supporting the development of *private training institutions*. In post-conflict and weak governance environments, state training institutions may be rife with corruption and completely de-capitalised by former or existing administrations. Furthermore, vocational training programmes are often specified in peace agreements and must fit into agreed demobilisation and reintegration schedules. The private sector may be in a better position to respond quickly to demand under these conditions and particularly when competition is possible, self-selected enrolment rates will eventually be the arbiter of the quality of services provided.⁵⁸ It should be noted, however, that private sector participation in training services may require legislative and policy changes.

In addition to entrepreneurship training, **self-employment** strategies of ex-combatants and returnees may be further assisted by the provision of *toolkits* that include basic tools and equipment *and start-up capital* in the form of micro loans or grants. Where possible and cost-effective, kits supplied by local businesses may be preferred over imports in order to assist the re-establishment of supply networks within the local economy. The Practical Field and Classroom Guide for Disarmament, Demobilisation and Reintegration developed by a group of donor agencies, suggests that micro grants may be a more effective instrument in supporting the self-employment start-up capital requirements of demobilised ex-combatants in many post-conflict settings.^{59 60}

⁵⁶ See Humphreys and Weinstein (2004).

⁵⁷ See Grunwald et al. (2004), “*Work in Progress, Making the Case for Skills Development in the Context of Pro-Poor Development: Looking for Sustainable Approaches*”, GTZ, Eschborn and World Bank (2004)

⁵⁸ Ibid

⁵⁹ See Gleichmann et al. (2004)

⁶⁰ The limited list of essential conditions for microfinance advanced in the previous section indicates the need for more research on the potential for appropriate credit technologies for ex-combatants.

Labour Insertion Services encompass the range of interventions designed to help ex-combatants and returnees find employment. Many of these instruments have already been previously described. These included financial subsidies to SMEs, placement in labour-intensive small scale infrastructure projects, on-the-job and traditional apprenticeship training schemes. Knowledge of when, where, what kind and how much labour is required by various small businesses or small scale infrastructure projects is a central concern for effective implementation of these instruments. As a result, extensive information and coordination networks are required. The activities to establish these networks are often organised under the moniker of Information and Referral Services within reintegration and reconstruction programmes.

Through registering the demand and supply of employment opportunities in specific locations, Information and Referral Services may serve a primary economic function in assisting the clearance labour markets in post-conflict settings. Information collected through the socio-economic profiling of ex-combatants and returnees may provide the basis for the supply side of local markets. Matching supply to the specific demands of local employers often requires additional and more complex data collection exercises. This can include detailed assessments of the local constraints and opportunities facing individual and groups of SMEs. The information and experience gained through this exchange can be used to form the core of future SME development programmes.

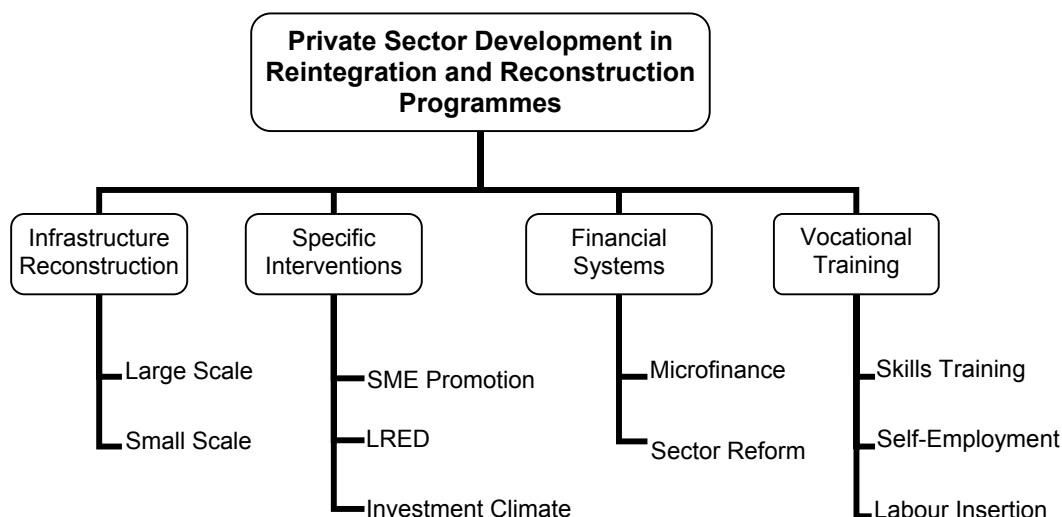
Beyond their economic function, Information and Referral Services can play an important role in the reducing conflict. If, as the old saying goes, truth is the first victim of war, then it might be fair to judge that information and coordination are equally injured parties in many post-conflict settings. There are scores of reports outlining the challenges of aid harmonisation under normal circumstances. In post-conflict settings, these shortcomings may have immediate and serious implications for peace processes. For example, the UN in Mozambique recorded more than 500 serious incidences of violence including demonstrations, occupations, and hostage-takings during the demobilisation and reintegration phases. These incidents left a number of people dead and scores of others injured. It was subsequently concluded that over 90% of cases resulted from demands to which there were legitimate entitlements. This is not meant as a justification of violence, but rather an indication of the importance of promoting public information for entitlements and obligations for common standards, transparency and accountability of service providers in reintegration and reconstruction programmes.

In summary, skills training, self-employment and labour insertion strategies comprise central elements of many post-conflict reintegration and reconstruction programmes. There are often, however, a number of factors which determine the choice among or systematic combination of these and previously mentioned strategies. These factors are discussed in next section.

3.5 Systematic Combination of Strategies

Despite the possible preponderance of economic root causes, each conflict and hence post-conflict situation involves a different set of personalities, institutional actors and cultural norms. These and other differences mediate the shape of reintegration and reconstruction programmes. Furthermore, by way of example, the potential for private sector development in post-conflict Sierra Leone is likely to be substantially different from the opportunities available in post-conflict Guatemala. The implication for aid programmes is simple: one size does not fit all. Based on this premise, this section examines factors which may affect the choice among or systematic combination of strategies for private sector development within post-conflict reintegration and reconstruction programmes.

Figure 3.5 - Summary of Strategies



The various strategies for promoting private sector development in post-conflict settings presented in this paper are illustrated in Figure 3.5 above. The choice among these strategies must be guided by detailed studies such as needs assessments and socio-economic profiling to enable programme designs which fit the country context. The opportunities and constraints for SME participation must be identified along with the existing capacity of government structures. In this regard, various models exist for benchmarking investment climate indicators and pinpointing obstacles to private sector development.⁶¹ However, despite the existence of these tools to inform programme design, there may be a number of other critical factors and often relatively subjective assessments that should also be considered. Examples include:

- Availability of funding (Volume and number of donors)
- Volume and percentage of ex-combatants and returnees within the population
- Original state of development and extent of destruction
- Strength of governance structures and prevalence of corruption
- Animosity between former parties to conflict and divisions within business community

The answers to some of these fundamental questions are not always readily apparent in chaotic post-conflict settings. For example, even essentially objective figures such as the volume of funding or the number of ex-combatants may need to be cautiously examined in design calculations. This is because it is not uncommon for actual amounts and timing of aid

⁶¹ See the investment climate pages at www.worldbank.org and www.ifc.org

to fall considerably short of original promises. As well, often due to local politics, definitions of who qualifies as an ex-combatant may shift during implementation and render key design assumptions invalid.

There are few tried and tested analytical tools to assist in subjective assessments, such as the strength of governance, levels of animosity, or divisions within business communities. Several international measures, such as the Corruption Index by Transparency International or the Governance Index by the World Bank may provide an indication of general trends, but they remain relatively blunt instruments to define specific interventions at local levels.⁶² Promising experiments with new tools, such as Peace and Conflict Impact Assessment (PCIA) are currently being undertaken for this purpose. These tools question proposed interventions based on their potential impact on a range of indicators for conflict at local levels. They examine potential impact on the struggle for power; access to resources; corruption; information and transparency; cultural diversity; and, regional cooperation.⁶³ It should be noted, however, that while promising, experience with these tools is still at an early stage.

Generally, the systematic combination of strategies for private sector development begins with skills training programmes. At the micro-level, skill training enhances opportunities for either self-employment or employment in SMEs. Both opportunities can be supported by increasing access to microfinance and business skills training. SME promotion strategies can also include employment subsidies and linkage programmes to small-scale infrastructure and reconstruction programmes. At the meso-level, groups of businesses defined either through sector or geographical area can be assisted through strategies to promote LRED. At the same time, but at the macro-level, strategies to rehabilitate large-scale infrastructure, improve the financial sector and remove further obstacles to investment can be coordinated to promote private sector development.

Specific country conditions, as mentioned above, must be applied to the general model to determine priorities among the various strategies. While there are no exact formulas because of often large difference in implementing environments, emerging experience indicates certain 'rules of thumb' may be useful for programme design decisions. These rules of thumb are meant simply as caveats. They include:

- Micro-level strategies involving skills training, SME promotion and microfinance are likely to be most effective in meeting short-term employment objectives in immediate post-conflict periods.
- Micro-level strategies alone are unlikely to address long-term cycles of underdevelopment. This indicates a need for a micro, meso and macro level strategies.

⁶² Kaufmann, D., A. Kraay, et al. (2005). *Governance Matters IV: New Data, New Challenges*, World Bank

⁶³ MacDonal (2005)

- Micro-level strategies involving microfinance are subject to relatively few essential conditions and can, if professionally managed, reach high volumes and a broad target groups.
- Micro-level strategies may be prone to rent-seeking. This can increase the challenges of implementation in weak governance environments.
- Meso-level strategies involving group or regional cooperation reflect concepts typically associated with peace building and reconciliation.
- Meso-level strategies, due to a greater reliance on principles of transparency, may be useful in balancing negative effects in predatory states.
- Macro-level strategies to improve large scale infrastructure, financial systems and the investment may be necessary to enable SMEs to fully participate in the reconstruction boom that typically follows peace agreements. This indicates the need to initiate reforms as soon as possible in post-conflict settings.

While these rules of thumb may be far from complete, they do offer a reasonable starting point from country specific factors may be interpreted and applied in the design of initiatives to promote private sector development in post-conflict reintegration and reconstruction programmes.

4. Summary and Conclusion

This paper proposes a framework for private sector promotion in post-conflict environments. It began by investigating the evidence linking economic development and conflict. This was followed by summary of current trends in economic development under normal circumstances and the definitions of conditions specific to post-conflict environments. The challenge that emerges is to balance immediate concerns for security while laying the foundation for economic growth through private sector development. From this basis, the proposed framework for intervention incorporates short-term reconstruction processes and long-term economic development strategies.

The suggested framework contains four main pillars. These include: enhanced participation of the private sector in the reconstruction of social and economic infrastructure; specific interventions to promote private sector development; improvements in the financial sector; and strengthening labour markets through post-conflict vocational training. A focus on addressing investment climate constraints much earlier in reintegration and reconstruction phases is suggested as the glue to integrate the various components.

Post-conflict reconstruction of social and economic infrastructure can create important short-term employment opportunities during the fragile transition to peace. Small-scale infrastructure programmes can be designed to accommodate pressing demands for employment during transition periods, promote local businesses, increase the credibility of government structures, and improve the local investment climate. Large-scale economic infrastructure programmes can, if properly coordinated, make significant contributions to the long-term productivity of businesses. Given normal lead times and trends in absorptive capacity, preparations for large-scale infrastructure programmes should begin in the immediate post-conflict period.

Specific interventions to promote private sector development can be divided into micro, meso and macro level categories. At the micro-level, employment subsidies and post-conflict regional economic promotion should focus on building local capacity for business development centres, sector strategies and regional trade initiatives. Initial indications are that private business development centres may be more cost-effective and sustainable over the long-term. Regional agriculture trade policies should be analysed from a conflict-sensitive perspective due to their potentially significant impact on rural farm incomes.

Post-conflict improvements in the financial system should focus on microfinance and systemic challenges in financial sector. Microfinance can be an extremely effective instrument for promoting micro-enterprise formation during post-conflict periods and there are relatively few preconditions to satisfy before initiating programmes. Addressing systemic challenges in the financial sector can begin with interventions that promote greater competition. This is likely to exert greater pressure on domestic financial institutions to improve the quality of their services and the introduction of non-financial intermediaries can lead to a broader range of financial services.

Strengthening post-conflict labour markets should focus on vocational training and employment promotion measures. The private sector can be involved in the supply of toolkits, curriculum design, rehabilitation of training facilities, delivery of training programs, and benefit from employment promotion programmes. Employment subsidies may be required facilitate the economic reintegration of ex-combatants and refugees. Entrepreneurship training can be combined with microfinance to assist self-help strategies and promote the sustainability of small firms.

In conclusion, private sector development can contribute to economic growth. Stronger economies raise opportunity costs for armed rebellion and lower the probability of conflict. If conflict does occur in cycles, then the timing of interventions becomes important. These factors argue strongly in favour of earlier and more profound efforts to strengthen the role of private sector development in post-conflict reintegration and reconstruction programmes.

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