CHAPTER 4

ECONOMIC RECONSTRUCTION AND REFORMS IN POST-CONFLICT COUNTRIES

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Introduction

The failure of economic reconstruction of poor countries coming out of armed conflict that have embarked on the complex transition to peace has been a major obstacle to peacebuilding in the post-Cold-War period. With war raging in the Middle East and Africa, and with countries engaging in economic reconstruction after civil war, military intervention, and/or regime change across various continents, we must revisit and reflect on this failure and find ways to avoid repeating it.

As wars or chaos end, countries enter into a multi-pronged transition to peace: institutions for public security must be established or modernized so as to bring crime and violence under control ('security transition'); repressive governments must give way to the rule of law and participatory governance, both at the national and local level ('political transition'); ethnic, religious, or class confrontation must give in to national reconciliation so that former enemies can return to the same villages and coexist in peace ('social transition'); and war-ravaged, mismanaged, and largely illegal economies must be reconstructed and become viable economies that enable former combatants, other groups affected by the conflict, and ordinary people to earn a decent and legitimate living in a sustainable way ('economic transition').

Although our analysis focuses on the economic transition itself, the four aspects of the multi-pronged transition to peace are closely interrelated and reinforce each other. Failure in any one of these puts the others at risk. It is understandable, and to be expected, that such an overwhelming transition should necessarily take a long time and confront enormous challenges. But this has often been ignored.

Why has the transition to peace proved so difficult in the post-Cold-War period? Most probably, the main reason is that the standards imposed by the international community[1] for countries in this transition have been too high and unrealistic. Indeed, donors have pushed these countries to become a mirror image of themselves. As if war had no consequences, donors have made 'democracy' and 'markets' the guiding principles for building the new societies.

This could be grounded in the ideological belief that only a society based on these principles is capable of achieving and preserving peace and stability and of generating increased prosperity. A less benign interpretation is that such efforts are designed to create a favourable business environment, particularly in countries rich in natural resources, upon which companies, contractors, and experts from donor countries can thrive (Blejer and del Castillo forthcoming).

In the political area, countries often embark on a slow and painful transition, with transitional governments often lacking the political legitimacy to carry out basic policies, and with large parts of the country outside their control. In some cases, countries have been pushed into elections and political processes for which they were not ready and end up with weak, corrupt, and ineffective leadership. In the security area, unnecessary delays in creating national security forces and in deploying sufficient UN peacekeepers or foreign troops have often put the transition at risk.

The disarming, demobilization, and productive reintegration of former combatants and other armed militias is a critical aspect of the 'social transition' which has proved to be a *sine qua non* for a successful transition to peace and national reconciliation. Although this programme should have priority, productive reintegration requires sustainable jobs and livelihoods that countries have mostly failed to create as they emerge from war. Temporary public jobs in infrastructure rehabilitation and other such unsustainable private jobs with foreign agencies have proved inadequate to the task. Failure in the economic area to create viable opportunities has often led to failure in the social and security areas, since national reconciliation and security require sustainable employment to reintegrate former combatants of both sides, militias, and other groups giving up arms.

Despite the fact that the Bretton Woods institutions—the International Monetary Fund (IMF) and the World Bank—have over time improved the terms of their assistance to war-torn and other fragile societies (del Castillo 2008b: 1281–92; 2010: 88–90), as they have improved the way they work together with the UN in those countries, an undeniable policy of these institutions has been to use their advice and lending conditionality to create a perfect macroeconomic framework based on

[1] The term is used to include all stakeholders involved in supporting countries in the war-to-peace transition as donors or providers of technical assistance, including the UN and its agencies, member states, other bilateral and multilateral donors, and NGOs.

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inflexible monetary and fiscal policies[2] and unrealistic targets, which is totally inadequate for the circumstances (del Castillo 2008a: 177–9).[3]

In this way, war-torn, politically unstable, insecure, mismanaged, and destitute societies have been expected to turn overnight into liberal democracies with free-market economies pursuing 'first-best' economic policies, efficient private sectors, and independent central banks. This was expected of them despite the fact that they mostly lacked the basic requirements for free markets to work efficiently, and in general required strong and paternalistic governments to survive in the immediate term.

But the record speaks for itself. Efforts to transform war-torn countries overnight have indeed been disappointing—roughly half of the countries that entered the multi-pronged transition to peace after the end of the Cold War relapsed into conflict within only a few years.[4]

Of the half that managed to keep a tenuous political peace, the large majority ended up with an unviable economy and large dependency on foreign aid. Some, such as Mozambique, have experienced two decades of peace during which they have received a tremendous amount of aid as a percentage of GDP but nevertheless remain at the bottom of the *Human Development Index*. Others, such as Afghanistan, have the disastrous record of having both returned to conflict and fallen into a dependency that will take decades to break. Only a few, such as El Salvador and Rwanda, have managed to avoid both returning to war and aid dependency (del Castillo 2014c: 153–5).[5]

[2] To be fair to the Bretton Woods institutions, in some cases it was the economic authorities of the sovereign countries who pushed for an orthodox macroeconomic framework. This was clearly the case with Afghanistan, where the then Finance Minister, a former World Bank official, pushed for monetary and fiscal policies totally inadequate for Afghanistan at the time (del Castillo 2014b: 181–3).

[3] Political scientists often criticize the IMF-supported stabilization and structural reform programmes without seeming to realize that countries cannot sustain fiscal and external deficits unless someone is willing to finance them. In the case of El Salvador, for example, because of its income per capita, the country did not have access to concessional financing except from USAID and UN agencies, which covered only about 30 per cent of their peace-related projects. Financing the rest at non-concessional terms was not easy, and indeed required austerity in other areas.

[4] According to the UN (2005: 31), 'roughly half of all countries that emerge from war lapse back into violence within five years'. The UN does not seem to have updated this figure, and we have seen many countries, including Afghanistan and Iraq with their large and costly peacebuilding efforts, reverting to war since then. Analysts using a wider sample, which includes countries that are not going through the complex multi-pronged transition discussed above, have estimated probabilities of relapsing into conflict ranging from 40 to 50 per cent. What matters more than an exact figure is that post-conflict countries have a much larger probability of descending into war than others, and that is why economic policies in these countries must be sensitive to conflict.

[5] See, in particular, Table 8.3 in del Castillo 2014c for aid comparisons across a number of countries during the first decade in the transition to peace. In El Salvador, the UN certified that most of the commitments under the National Reconstruction Plan were achieved by 1997 and the performance of the economy under the plan was impressive. However, in an effort to get out of the country in a speedy fashion, the UN left its business unfinished and the arms-for-land and other reintegration programmes proved unsustainable as the country transitioned to normal development. This, together with the short-sightedness of the United States in repatriating gangs from Los Angeles (the so-called *maras*), resulted in a sharp deterioration in security. (For details, see del Castillo 2001: 1967–85; 2008a:

A change in strategy is therefore urgently called for. Many argue that aid has been insufficient. But with economic and military aid to Afghanistan averaging at least 75 per cent of its GDP in 2002–14, and with the UN providing a large peacebuilding operation, aid was certainly not lacking (del Castillo 2014b: 231–41). The same is true of Liberia, Mozambique, and Haiti. A combination of misguided policies, misplaced priorities and sequencing, ineffective and fragmented aid, and widespread corruption lies behind the dismal record.

Before we can analyse the record and consider how to improve it, we need to define some basic concepts that—because they are used by different institutions and analysts in different contexts—frequently lead to confusion. The lack of precision with regard to terminology has often led to the conflation of short- and long-term policies, humanitarian and reconstruction policies, and economic and development policies, among others; this phenomenon has not only resulted in policy failure but has also caused unsustainable dependency on aid.

The purpose of this chapter is to argue that, irrespective of the way that wars or chaos end—be it through negotiations, military intervention, and/or regime change—the path, timing, and sequence of economic policies and structural reform are key to effective post-conflict reconstruction. Firstly, we shall posit that it is not possible to move from the economics of war to the economics of development without going through an intermediate phase—the economics of peace or post-conflict economic reconstruction. The main objective of this intermediate phase must be to avoid relapse into conflict. Thus, optimal or first-best economic policies are not always attainable or even desirable during this phase (del Castillo, 1995: 29–30; 2001: 1968, 1970; 2008a: 4).

Secondly, we shall argue that while dynamic growth may be a longer-term objective, in the short-run, the main objective should be to improve security and to ensure that the large majority of the population receives a peace dividend in the shape of restored basic livelihoods—even if only at subsistence levels. Without a rapid improvement in peoples' lives and livelihoods—through investment rather than humanitarian aid—economic reconstruction will be neither effective nor sustainable. Higher-productivity activities and first-best policies should follow as soon as possible.

Finally, we shall contend that, to avoid an unsustainable dependency, countries need to start replacing aid with foreign direct investment and net exports. We propose that this could be done through the creation of 'reconstruction zones'. Through conflict-sensitive government policies, these zones could provide an environment in which foreign investors and local communities collaborate in a 'win-win' strategy that could lead to improved security, stability, and prosperity for all.

103–36.) In Rwanda, despite its high dependency on aid after the genocide, the country has managed to reduce its dependency sharply. With strong, non-corrupt, and visionary leadership, both El Salvador and Rwanda often sought solutions outside the aid system. In El Salvador, for example, President Cristiani gave up benefits under US Government PL480 because he rightly decided that the long-term benefit of basic grain production was more important for the country than the short-term assistance provided under this programme.

Definitions and Characteristics

Before we can discuss the issue of economic reconstruction and reform in post-conflict countries we need to define the basic terminology: similar terms mean different things to different people and the use of terminology has even changed over time. The word 'economic reconstruction' is used to cover the destruction due to war, even though much needs to be built rather than rebuilt. The press and many analysts—as well as some politicians in donor countries—refer to economic reconstruction interchangeably with 'nation-building' (the construction of a national identity) or 'statebuilding' (the construction of a functioning state), or simply 'development', while the US State Department refers to it as 'post-conflict stabilization and reconstruction', the UN as 'peacebuilding', UNDP as 'early recovery', and the World Bank as 'post-conflict reconstruction'.

The terminology also varies with respect to time. While 'economic reconstruction' may last ten years or more, it nevertheless encompasses a specific time period, a time period that can be delineated, although with little precision (usually coinciding with the finalization of peace-related programmes and the agreement that there is a low probability that the country will relapse back into conflict). The 'development' of the country, on the other hand, is a long-term and often open-ended proposition. Development activities may start as the country emerges from war, but they will take time to have an impact, and so they may not, by themselves, facilitate the transition.

The meaning of the term 'economic reconstruction' has also evolved over time. During the Marshall Plan, the term referred mostly to the rehabilitation of basic services and infrastructure for the reactivation of world production and trade. Economic reconstruction at the time involved industrial countries that had strong institutional and policy frameworks in place and an educated labour force. At the same time, there was no need for 'national reconciliation'—an expensive proposition—since after an inter-state war former combatants would return to their own countries and did not have to coexist within the same physical space, as happens after intra-state wars.

By contrast, in the post-Cold-War context, 'economic reconstruction' should be defined more broadly to include not only the rehabilitation or creation of basic services and infrastructure destroyed during the war, but also the modernization or creation of a basic macro- and microeconomic institutional and policy framework necessary to create a viable economy. By 'viable', we refer to an economy that will provide people with employment opportunities that will allow them to make a decent and legitimate living. This is essential for the reintegration of former combatants and other conflict-affected groups into productive activities, which, as we said earlier, is a *sine qua non* for effective reconstruction.

As defined, economic reconstruction acquires a 'holistic meaning' involving activities ranging from the economics of boosting yields for small farmers to the business of getting initial access to capital, technology, and infrastructure for the creation of small and medium-sized enterprises, to the many aspects of the provision of health, education, safety, and security for families and children. Additionally, reconstruction involves the design of policies targeted at the reactivation of investment, production, and trade, and the management of aid.

In his *Agenda for Peace* (1992), UN Secretary-General Boutros-Ghali introduced the term 'post-conflict peace-building' (with hyphens dropping over time) as those activities aiming to prevent the recurrence of the outbreak of conflict, as opposed to 'preventive diplomacy', which involves activities aiming at averting a crisis in the first place. The term 'post-conflict countries' was used early on with reference to El Salvador, and it seemed like the perfect choice, given that the agreements negotiated through 1990 and 1991 brought the decade-long civil war to an end in an impeccably observed ceasefire. This was certainly not the case in countries such as Afghanistan, Iraq, and the DRC, where large parts of the country remained insecure or fell back into war not long after the countries had embarked on the war-to-peace transition.

Post-Conflict Economic Reconstruction: Path, Timing, and Sequence

In contrast to the time of the Marshall Plan, post-conflict economic reconstruction following the end of the Cold War failed to generate a rigorous theoretical and practical debate among policymakers, practitioners, donors, academics, economists, and other stakeholders. Key questions were never asked. How to design an overall strategy for effective reconstruction in the new context of poor countries coming out of civil war? How to address the different trade-offs and sequences involved in the process? How to deal with the economic and financial consequences of the transition to peace? Likewise, there was no effort to articulate the pros and cons of different programmes or to develop best-policy options, practices, and sequences for different situations.

In the absence of such debate, economic reconstruction was approached—both by national governments and by the international community that supported them—as if it were development as usual (del Castillo 2000: 227–30; 2008a: 4–5). This has clearly been a major reason for the dismal record of war-torn countries mentioned earlier.

Despite the fact that there are no 'cookie-cutter' solutions, good and bad experiences from the quarter of a century since the end of the Cold War allow us to identify things that can be done differently to make post-conflict economic reconstruction more effective. Although countries will require different strategies, different economic policies, and different policy sequences depending on factors that are peculiar to their own situation and to the level of international support that they can garner, there are nevertheless a number of commonalities with respect to the paths to be followed, the timing, and the sequence of economic policies.

For post-conflict economic reconstruction to succeed and for policies to be sustainable, it is important that sovereign governments harmonize policies and set priorities based on a wide national consensus. An arbitrary model based on donors' priorities should not be imposed on these countries. The UN system—including the IMF and the World Bank—together with bilateral and other multilateral agencies, NGOs, and other stakeholders should be in the back seat, facilitating, coordinating, and monitoring the international community's technical and financial support (de Soto and del Castillo 1994: 77).

During reconstruction, countries need to move along three different paths, which are by no means independent of each other. To keep the peace and to be able to stand, at the same time, on their own feet, countries need to be able to take these paths as soon as possible. Prolonging a country's dependence on humanitarian assistance or on external financial and technical support will make it lose ownership of its own policies, which will make such policies unsustainable. Deviations from these broad paths are likely to put peace, stability, self-reliance, and prosperity at risk.

The Path Towards Normal Development

Although the long-term objective is to bring war-torn countries back onto a path of normal development where optimal or first-best policies can be planned with a medium- and long-term horizon in mind, to get there countries need to go first through an intermediate phase: what is called 'post-conflict economic reconstruction' or 'the economics of peace'. The overriding objective of this phase must be to avoid relapsing into conflict, even if, in the process, economic stabilization and structural reform, as well as basic development benchmarks in terms of health, education, and infrastructure are delayed.

Reconstruction can only succeed if it helps to keep the peace in the short run and if it opens the path to long-term development. Such a path can only be found through dynamic growth and economic and social inclusion. In the short run, reconstruction is primarily a political process because any decision will have explicit or implicit political consequences that will either help to consolidate peace and reconciliation or push the country back into conflict.

Because the political (or peace) objective should always prevail over the economic (or development) one during this phase, a basic premise for effective reconstruction is that first-best economic policies are not always achievable or even desirable at this stage. This makes this phase fundamentally different from 'development as usual' in countries not affected by major conflict (del Castillo 1995: 29–30; 2008a: 40–2; 2011b: 4–5).

Whenever this premise has been ignored, countries have gone back to war or have found it difficult to resume the normal development path interrupted by the conflict. The economics of peace must have a dual purpose: to promote economic activity in an inclusive way so that the population at large can perceive a peace dividend in terms of better lives and livelihoods; and to ensure that policies followed by the government and their international supporters are conflict-sensitive so as to avoid aggravating social tensions.

Thus, despite the specific features of each transition, the reactivation of investment, employment, and livelihoods in a peace-supporting environment requires that countries move along the following path (del Castillo 2012b: 1):

ECONOMICS OF WAR
(or underground war economy)
↓
ECONOMICS OF PEACE
(or post-conflict economic reconstruction)
↓
ECONOMICS OF DEVELOPMENT
(or development as usual)

As war ends, countries need to move out of the 'economics of war' of the past—that is the underground economy of illicit, rent-seeking, and highly lucrative activities that thrive in situations of war or chaos amid dilapidated infrastructure and services and macroeconomic disequilibria. This requires overcoming the interests of 'spoilers' who have an economic stake in such activities, including drug production and trafficking, smuggling, extortion, and the many other illicit activities that thrive during wars, including aid manipulation.[6]

One of the factors that has impeded countries from standing on their own feet in the transition to peace is the effort to move directly from the 'economics of war' to the 'economics of development'—development as usual practices, optimal policies, and best practices—as if countries were unaffected by war. Although it is true that post-conflict countries face the development challenges that other countries do, such as alleviating poverty and complying with the UN development goals, these are long-term propositions. In the short run, the challenge of post-conflict economic reconstruction is primarily to contribute to national reconciliation and the consolidation of peace. Unless this succeeds, peace is not going to be long-lasting. Without peace, development will not be sustainable.

Time is of the essence in the post-conflict period. Under normal development, economic policies and programmes aimed at addressing economic stagnation, backwardness, weak institutions, poor human resources, poverty, and other pathologies of underdevelopment are planned with a medium and long-term horizon in mind, but no such luxury exists during post-conflict reconstruction.

Thus, a second basic premise for effective economic reconstruction is that, as countries come out of war, emergency policies adopted decisively and without delay

[6] As Weiss and Hoffman (2005: 299–300) noted, unusual predatory economic opportunities abound during reconstruction, including the appropriation of aid for illegal purposes.

are needed to deal with homeless populations, hunger and diseases, demobilizing fighters, returnees, and displaced populations, as well as all other immediate needs created by the crisis. These policies often serve a short-term humanitarian, political, or security purpose, but often create economic distortions and have other unintended consequences on medium- and long-term development. Delays in approving disbursement of funds in the immediate transition to peace and misguided priorities—reflecting the 'development as usual' approach of multilateral and bilateral development organizations—have often impeded effective reconstruction and need to be avoided at all cost.

In post-conflict situations, priority must often be given to groups most affected by the conflict and most likely to take up arms again. Thus, a third premise for effective economic reconstruction is that policymakers often need to put aside the guiding development principle of equity (that is, the principle of treating equally all groups with the same needs) in favour of the reconstruction (or political) principle, which justifies giving special treatment to groups that most suffered from the war or are most likely to return to it—even in the presence of others with similar economic needs.[7]

For peace to be long-lasting, reconstruction policies should be targeted towards decreasing the grievances of those groups. Because women, children, and youth groups have been involved as combatants, have played many other roles, and have been victims of specific violence against them during the conflict, reintegration programmes that include them, together with male combatants, are particularly important to address and redress some of these problems.

The experience of the last two decades has proved that reintegration is the most complex, challenging, expensive, and long-term activity relating to post-conflict reconstruction and the one in which the political and economic objectives of reconstruction are most intertwined for national reconciliation. The success of reintegration programmes is often dependent on economic recovery and foreign financing but it also depends on good planning, timing, and sequencing. For example, one of the major problems of the 'arms-for-land' reintegration programme in El Salvador was that land was made available to beneficiaries of the programme but many of them did not have a house to live in or credit for production, with the result that they soon abandoned the land.

[7] This was strongly opposed by the World Bank and UNDP in El Salvador, despite the fact that the 'arms-for-land' programme was part of the UN-brokered peace agreement. Following the 'equity principle' of normal development, rather than the 'ethics of reconstruction', World Bank officials responsible for El Salvador argued in 1993 that there were 300,000 peasants without land in El Salvador, and that preference should not be given to a few. The discussions took place with members of the office of the UN Secretary-General. World Bank policy changed in fundamental ways after James Wolfensohn took over in 1995. The Bank became involved in supporting post-conflict economic reconstruction, including reintegration efforts, although even a year earlier, in 1994, the Bank had begun work on reintegration in Uganda (del Castillo 2008a: 43–5).

Another striking example of the mistakes that can be made in resettling refugees and with reintegration programmes in general is the Alice-Ghan project in Afghanistan. In 2007, the United Nations Development Programme (UNDP) started a housing project for thousands of returnees from Pakistan and Iran. The project soon turned sour as plans to bring water from a neighbouring community were shattered, clearly showing the problem in sequencing, as the UNDP had built housing in the most arid land expecting that water would follow. Alice-Ghan was located fifty miles from Kabul, where jobs could be found; subsistence agriculture could not be practised because of the lack of water; and families could not settle given the lack of schools and clinics. Moreover, houses lacked the type of privacy that conservative returnees required. As the *New York Times* reported in an article entitled 'In Afghanistan, a Village Is a Model of Dashed Hopes':

> Five years later, the village of Alice-Ghan and those good intentions are tilting towards ruin. Most of the 1,100 houses have been abandoned to vandals and the lashing winds. With few services or jobs within reach, hundreds of residents have moved away—sometimes even to the slums and temporary shelters they had sought to escape. (Healy 2011)[8]

Successful reintegration is often dependent also on governments making difficult political and financial decisions to solve critical problems relating to, among other things, property rights, lack of credit, housing, services, and technical assistance. Governments need to carry out reintegration efforts continuously and implacably, from the early emergency phase to the end of post-conflict economic reconstruction, when the country moves back into a normal development path (del Castillo 2008a: 255–71).

In a nutshell, policymaking during the reconstruction phase has less freedom of action, requires a sense of urgency and forgiveness of distortions, and needs to disregard the equity principle applied under normal development in order to reintegrate groups that have been most affected by the crisis. At the same time, these countries face the challenge of utilizing large and quickly reversible volumes of aid and, as a result, to deal with the large political and military involvement of the international community, which often has its own agenda. The key challenge is to ensure that economic policies are conflict-sensitive, that is, tailored to do minimal harm to the fragile peace and to rein in spoilers.

The pace and sequence of reform during the reconstruction phase will be very much dependent on the type of economy, on its initial conditions following the war, on the domestic capabilities of its civil service and the rest of the labour force, and on the availability of foreign financing and private remittances. Particularly in countries where basic institutions have stopped functioning or are extremely weak, the first step should be to prepare a realistic assessment of economic and financial conditions and

[8] For a detailed discussion of Alice-Ghan and the problems created by poor planning and wrong sequence of reintegration programmes, see del Castillo (2014b: 228–30).

needs. Unrealistic assessments, such as that conducted in Afghanistan by the Asian Development Bank, the World Bank, and the UNDP in 2001 (Asian Development Bank et al. 2002), have subsequently come back to haunt reconstruction efforts. In the case of Afghanistan, not only was the $15 billion assessment for the total cost of reconstruction totally off-target, but the development organizations went well beyond a financial assessment to make policy recommendations for a 'development as usual' approach to reconstruction that was clearly associated with its unrealistic expectations and ultimate failure (del Castillo 2014b: 176).

The needs assessment report recommended that investment in rehabilitation and reconstruction should 'be contingent on having an appropriate policy and institutional framework in place' (Asian Development Bank et al. 2002). This certainly set the country off on the wrong foot in its post-conflict transition. Creating such a framework would clearly take time that Afghanistan did not have and could not afford. Without a peace dividend for the large majority in terms of improved services, food security, and other basic daily necessities, the country would relapse into conflict, as indeed it did soon after.

With regard to the pace and sequence of macroeconomic stabilization policies, it should be remembered that countries can only run fiscal and external deficits if someone is willing to finance them. Hence, countries such as Liberia, Haiti, and Afghanistan have been able to carry large budgetary and external disequilibria for a long time at the expense of aid dependency. Others have had to engage in tough stabilization and reform programmes, usually under IMF sponsorship, to bring their macroeconomic imbalances down to match their capacity to finance them. That was the case of El Salvador, as discussed earlier.

In terms of economic reform, there are certain activities that entail a specific sequence, and which may not be possible to carry out unless others take place before them. For example, even if policymakers want to start providing credit for micro-enterprises immediately, this will not be possible until the monetary authorities and the basic legal framework are in place. In Kosovo, for example, the first challenge was to restore the payments system, without which all other policies would have been ineffective. In many countries, reactivating agriculture may not be possible without first de-mining fields and roads. Currency exchange was necessary in Iraq to eliminate Saddam Hussein's portrait from the banknotes; in Afghanistan, it was necessary because of the existence of several currencies and the large degree of counterfeiting.

Resources allocated to large infrastructure projects in insecure environments will often be wasted; in Iraq and Afghanistan infrastructure was built and blown up as it was being constructed, with a result much like the experience of jogging on a treadmill. Billions were lost in the process. For this reason it is better, in insecure environments, to start with small projects.

Moreover, in cases where interim governments have been installed, both the pace and sequence of reform may reflect the authorities' lack of legitimacy to carry out certain policies and the uncertainty about property rights, which might be a strong disincentive to investment. The same was true with the UN-led interim administration of Kosovo and Timor-Leste and the US-led one in Iraq.[9]

The Path Towards Dynamic Growth

Dynamic growth is indeed the longer-term objective path of post-conflict countries whose economies need to 'catch up' after years of war. In the short-run, the main goal should be to improve security so that people can go back to their normal daily lives and can restore basic livelihoods—even if only at subsistence levels. This should be done through investment rather than largely through access to humanitarian aid, as has been the case. Higher-productivity investments can follow once the necessary policy and institutional framework and the basic infrastructure are all in place.

Waiting for the latter to be in place before basic investment begins is indeed not an option that these countries can afford. Reconstruction needs to start within whatever political and economic framework the country has, since it cannot wait for the international institutions to get their act together or for civil servants to be trained to do it right. Waiting for optimal conditions may take a long time. In the meantime, the country will probably revert to conflict and become aid-dependent.

Because of unrealistic efforts by the international community to create modern market-based economies overnight with little government intervention to support economic activity, subsistence agriculture has been neglected despite the fact that in many of these countries 75 to 85 per cent of the population depends on this sector for its livelihood.

This has often led to a large part of the population either becoming dependent on food aid, a dependency from which countries have found it difficult to recover, or becoming drug producers, often with strong financial, technical, and logistical support from traffickers. At the same time, there is a tendency in these countries to build the infrastructure and services that are of greatest benefit to the most productive investors—including foreign investors and a small domestic elite—to carry out commercial agriculture and other higher-productivity projects in manufacturing, mining, and services, without creating a level playing field for the large majority of the population (see the following section 'The Path Towards Fostering Inclusive Capitalism and Self-Reliance'). In this process, the unintended consequence is that donors often end up supporting economic elites of warlords, corrupt officials, and others who have accumulated capital during the war through corruption and illicit activities. Thus, rather than moving away from the economics of war, donors' practices often entrench corruption and other illicit practices of the underground economy in the post-conflict period.

[9] For an extensive discussion of uncertainty with property rights in Kosovo and Iraq as a result of the lack of sovereign governments making executive decisions, see the case studies in del Castillo (2008a: 151–3 and 207–8).

By supporting the most productive sectors and neglecting early support for subsistence agriculture, small farmers, and other micro and small enterprises, the international community is setting up an economic framework in war-torn countries that inevitably leads to large inequality and injustice, which will sow the seeds for further conflict. Thus, while 'inequality' has become the buzzword in industrial countries, with parties both on the left and on the right arguing that it needs to be reduced, the international community is supporting post-conflict policies that inevitably will lead to large inequality in war-torn countries.

Because of the importance of rural development to the population of most war-torn countries, supporting subsistence agriculture and rural development in an integrated manner is essential at an early stage in the transition. Without a rapid improvement in peoples' lives, economic reconstruction will be neither effective nor sustainable. Humanitarian (or charity) aid for the provision of food, shelter, potable water, medical care, and returnees' resettlement helps to support life and to provide minimum levels of consumption. However, by affecting relative prices and discouraging labour supply, domestic production, and the building up of domestic capabilities, a continuation of this type of aid over extended periods creates all kinds of price and wage distortions, discourages investment, threatens self-sustainability, and creates aid dependencies (including for food). It should be phased out as soon as possible.

Humanitarian assistance can save lives, but it is important to make these lives worth living. Only reconstruction (or economic) aid targeting investment opportunities that use local capabilities, land, and natural resources can increase the productive capability of the country and its people. The economic impact of reconstruction aid, however, will depend on how productively it is invested, and the impact it has on the labour market, on the exchange rate, on reactivating production and trade, and on protecting the environment.

An important lesson from the Marshall Plan that has been disregarded in the post-Cold-War period is that humanitarian aid is fundamentally different from reconstruction aid. In fact, the distinction has become blurred in the present context—with the same agencies, NGOs, or military forces often providing both. As Allen Dulles argued in *The Marshall Plan* (1993), it would be a waste of money merely to provide humanitarian aid to feed the Europeans for a year or two; reconstruction aid was necessary to give them the tools without which they would have little chance of righting their own post-war economies. He also stressed that policies adopted during the first year of the plan would be decisive in determining how effectively reconstruction proceeded. The same is true in the present context.

At the same time, reconstruction aid must not follow a piecemeal approach of having one donor build a school or clinic here, another one a road there, and still a third one a dam elsewhere, as has been the practice, particularly in countries such as Afghanistan and Haiti where donor presence has been large. To be effective, reconstruction aid needs to be provided in an integrated manner, taking into account local conditions and local needs. This requires that donors channel their aid through the national budget, rather than off-budget according to their own agendas.[10]

Perhaps Afghanistan illustrates best the wrong path to dynamic growth and the consequences of it. By the end of 2001, the US Agency for International Development (USAID) frantically started hiring foreign experts and contractors, luring them with huge salaries and fees to set up a modern economic, legal, and regulatory framework for policymaking in Afghanistan. Likewise, the UN, the Bretton Woods institutions and other UN and bilateral agencies, NGOs, and a variety of other stakeholders also flooded Kabul with new recruits.

By embarking on the creation of a first-best policy and ~~an~~ institutional framework so as to provide 'the enabling environment for the operation of the private sector' (Afghanistan 2002: 6), in which the Central Bank had full independence from the government and there was a 'no-overdraft rule' for budget financing, the basic premise for effective reconstruction—that the economic framework of war-torn countries should be simple and flexible (del Castillo 2008a: 47)—was totally ignored.

By contrast, the government should have used all the aid it had or could get in early 2002 to reactivate subsistence agriculture and minimize food aid, as well as to reactivate other kinds of legitimate business activities and to promote other job-creating investments in basic services and infrastructure. The government should have adopted less-than-optimal economic policies—including subsidies, price support mechanisms, and every other tool in its arsenal—to promote food production and to ensure a swift move from illicit production, even if the legal activities remained in the informal sector for quite some time. The government should have done this despite the low productivity that such activities may have had initially and despite the fact that farmers would have to be compensated handsomely to shift from poppies to legal crops providing much lower income.

Thus, the move that would have facilitated the reduction in illicit activities—critical to the economics of peace—and would have decreased the need for further food aid and imports should have been as follows (del Castillo 2014b: 184–187):

ILLICIT INFORMAL SECTOR
(poppy production, trafficking, smuggling, extortion)
↓
LEGITIMATE INFORMAL SECTOR
(subsistence agriculture and other production supported by government subsidies and price support mechanisms to compensate for any lost income)
↓
LEGITIMATE FORMAL SECTOR
(higher productivity export crops and other manufacturing, mining, and service activities)

[10] In Afghanistan, for example, only about 20 to 25 per cent of aid was channelled through the government budget (del Castillo 2014b: 190).

This path would have increased Afghanistan's food self-reliance (which the country had achieved before the war) and allowed farmers to support themselves in a legitimate and dignified way. Just as importantly, it would have limited the pervasive political and security impact of warlords, corrupt government officials, and the insurgency empowered by the high profits in the illicit sector. Optimal policies, institutions, elections, governance, security, human capacity, and jobs in the formal sector should have been an end result—not a precondition.

As Nobel Laureate Edmund Phelps wrote in the preface to *Rebuilding War-Torn States: The Challenge of Post-Conflict Economic Reconstruction* (del Castillo 2008a: ix):

> The idea promoted by some multilateral and bilateral donors that the war-torn countries can afford to follow laissez-faire policies—that in these countries unfettered markets work best and only the advanced countries need the paraphernalia of subsidies, licenses, regulations, corrective taxes, and so forth—is a costly ideology. In a war-torn country where the economy has been devastated and may not bear the fruits of centuries of experimentation and diversification, there may be a need for judicious and well-designed departures from laissez-faire—just as the United States in the early years of the republic adopted some of the infant industry ideas of Alexander Hamilton. Prohibitions against any and all interventions in the market place in a country whose institutions and culture have been destabilized seem dogmatic and injudicious.

The Path Towards Fostering Inclusive Capitalism and Self-Reliance

In the post-conflict context, countries are highly dependent on aid. It is important that foreign direct investment and net exports start replacing aid as major sources of foreign exchange as soon as feasible so that countries can avoid or come out of the debt trap in which many fall or already find themselves, and be able to stand on their own feet.

Attracting foreign direct investment—including into potentially highly profitable ventures for the exploitation of natural resources (mining, energy, and agriculture)—is not easy due to poor security and general uncertainty in these countries, as well as to many business-climate problems (lack of infrastructure, utilities, skills, weak judiciary systems to enforce contracts, etc.) that make investment highly risky and costly.[11] Attracting foreign direct investment for the domestic market is particularly difficult because of the lack of purchasing power at the local level.

At the same time, conflict-insensitive government policies of giving specific tax and other preferences and of building infrastructure and services targeting the needs of

[11] Greed over natural resources often leads investors to invest in highly insecure areas. Emerging-market investors are often willing to take more and different risks than traditional investors from the USA, Europe, or Japan. For a discussion of the challenges and opportunities of attracting foreign direct investment into natural-resource exploitation in war-torn countries, see del Castillo (2014a).

foreign investors and domestic elites—while ignoring the needs of farmers, small investors, and local communities—increase security risks due to the likelihood of confrontation between the two groups. Moreover, by failing to provide a level playing field for farmers and small entrepreneurs, including women, these countries miss out on the productive capacity and creativity of a large part of the population, making inclusive growth elusive.

To improve the post-conflict record of war-torn countries, we cannot keep on doing the same things that have not worked in the past over and over again and expect that this time the results will be different. Since building a school here, a road there, and a dam elsewhere hoping that these will eventually stimulate production and employment in the country has clearly not worked, the proposal for 'reconstruction zones' was offered as an integrated model for Afghanistan, Haiti, and Liberia,[12] three highly aid-dependent countries that need to move towards more inclusive capitalism and self-reliance.

Since the details of these zones have been discussed elsewhere, it suffices to say here that the 'reconstruction zones' would consist of two distinct but linked areas to ensure synergy between them—an 'export zone' producing exclusively for exports and a 'local zone' producing for local consumption.

Within the borders of gated export zones, the government could provide basic infrastructure, services, security, and a stable legal and regulatory framework for foreign investors that it could not provide across the country. In exchange, investors would commit to train local workers, create employment by purchasing local inputs and services, improve corporate practices and the standards of local providers, facilitate the transfer of innovative and productivity-enhancing technologies, and establish links with local technical schools and universities. Export zones could exploit natural resources in the agriculture and mining sectors, process agricultural products, or assemble low-skilled manufacturing goods.

The local zones would focus on integrated rural development of agricultural and livestock products for the domestic market to boost food supplies and reduce dependence on imports.[13] By providing a level playing field for men and women in the communities in terms of security, social services, infrastructure, credit, and other inputs (such as seeds, fertilizers, and agricultural machinery), the local zones would also help to bolster gender empowerment in the rural areas where the productivity of women is low precisely because they do not have access to these inputs.

The purpose of stimulating synergy between the export and local zones is to avoid the problems usually associated with enclave production for export, particularly with

[12] The author developed the idea of 'reconstruction zones' at the request of the United States Institute of Peace for Afghanistan and Haiti, and later on, at the request of UNU-Wider, made recommendations for Liberia (del Castillo 2011a; 2012a).

[13] In Afghanistan, the local zones could complement the government's National Solidarity Programme—a programme that has succeeded in improving local governance but has lacked a mandate for income-generating activities.

the rural communities in their vicinity that have often been displaced or have seen their livelihoods threatened by them.[14]

The purpose of reconstruction zones is also to address head-on the main impediments to private-sector development in rural areas. By redressing the bias against farmers and other small producers and providing opportunities for the communities, business development in the local zones could lead to more inclusive and sustainable growth. This could only be done with financial and other support from investors as well as with a more effective and integrated use of aid in the local zones. In exchange, the communities would ensure that security is maintained in the zones, lowering the investment risk that foreign investors face in these countries.[15]

With the right legal and regulatory framework and with the creation of business opportunities for the communities, the zones could be expected to create positive externalities or spillovers among different activities in the zones in particular, and eventually with the local economy in general.

An integrated approach, such as that of the reconstruction zones, is not only necessary to attract foreign investors and avoid resistance from local communities, but it is essential to stop educating people for jobs that do not exist, or building roads in areas where there are not enough productive activities for them to be used, or building schools/clinics for which there are no teachers/doctors, or providing seeds to farmers who do not have the technical skills to use them effectively. Unfortunately, this has been typical of the story of post-conflict economic reconstruction during the last quarter of a century.

In the process of reactivating the economy in a balanced and inclusive way through conflict-sensitive policies and no tolerance for corruption, reconstruction zones could become a major policy tool to improve human security, consolidate peace, improve aid effectiveness, reduce aid dependency, and move countries more rapidly towards self-reliance.

Inclusive capitalism has so far largely eluded post-conflict countries, perhaps with the exception of Rwanda, where people at large have seen a peace dividend, despite remaining extremely poor, with a per-capita income of roughly \$700 (about the same as Afghanistan). As Crisafulli and Redmond (2012) describe in *Rwanda Inc.*, the model that the country has followed conforms best to the three paths discussed here. Strong efforts at unification and reconciliation following the 1994 genocide were accompanied by strong government support for the subsistence agriculture that provides livelihoods

[14] Mining or agricultural concessions in Liberia, for example, have often created a number of human security threats by displacing indigenous communities and endangering their food security, as well as by destroying forests, wildlife, and ecosystems. Free-trade zones, such as those operating in Haiti, which often operate as enclaves as well, have also been associated with inadequate wages, poor working conditions, and even violation of basic human rights. For details and references, see del Castillo (2011a; 2012a).

[15] Fast growth in these three countries has relied mostly on the construction and service sectors geared towards the presence of the international community in the country, which is clearly unsustainable.

for 80 per cent of the population. Because the economic policies followed by the government of Rwanda have had a broad impact on the population at large, poverty reduction is a good indicator of the peace dividend enjoyed by Rwandans. Poverty was reduced from about 60 per cent in 2000 to below 45 per cent in 2010–11. According to the IMF (2014: 5), 'the poorest have benefited the most from growth. Inclusive growth has been led by policies geared towards agriculture through investments in fertilizers, improved seeds, electrification, irrigation, and rural roads and better provision of social services, especially to the rural poor. Access of the poor to financial services has also improved'.

The country is moving gradually into higher-productivity sectors and increased self-reliance by attracting foreign direct investment into a number of services and infrastructure projects, always through conflict-sensitive and inclusive policies to ensure that the population at large benefits from the investments. A point emphasized over and over by the authors is the importance of President Kagame's leadership, a strong, non-corrupt president, with a hands-on and can-do attitude and a clear vision that his country needs to reduce its reliance on aid (Crisafulli and Redmond 2012).[16] His authoritarian leadership, and the wider options he has managed to open for his country in terms of investment opportunities, has allowed him to stand up to the advice of the development agencies when he does not think their proposals are good for his people. This has ensured national ownership of Rwanda's economic policies, which is important to make them sustainable.

By contrast, the misguided policies, the misplaced priorities, and the ineffective and fragmented policies that development agencies have largely supported in other countries have led to an unsustainable record where only a small minority, many of whom are foreign, benefit from post-conflict economic reconstruction. The recipe offered by the international community of a combination of humanitarian assistance, relatively free elections, together with counter-insurgency and peacekeeping operations, without a significant improvement in the economic livelihoods and wellbeing of the large majority of the population has simply not worked. Indeed, ineffective use of aid to improve social services and basic infrastructure has left some of these countries particularly vulnerable to Ebola, natural disasters, and other calamities.

As we mentioned earlier, most of the major stakeholders supporting post-conflict economic countries have been very good at updating their rhetoric but very bad at putting it into action so that these countries can eventually move into the three interconnected paths towards normal development, dynamic growth, and inclusive capitalism and self-reliance. The World Bank and the IMF, for example, who have used only 'economic' or 'rapid' as adjectives to describe 'growth' for the majority of the last two decades, have in the last few years adopted the use of 'inclusive' to qualify both

[16] On the political area, however, human-rights experts complain about the lack of freedom of the press and other liberties and there is uncertainty about the political transition that Rwanda may face in the future.

'growth' and 'policies'. This is most encouraging, since the lack of broad-based, equitable, and sustainable growth has been one of the most serious obstacles to effective peacebuilding during this time. Although these organizations have overdone the rhetoric—with the Managing Director of the IMF using the word 'inclusive' or 'inclusiveness' eleven times in a speech to Rwanda's parliament in January 2015—it is about time that such rhetoric at the Bretton Woods and other development agencies was converted into concrete action in support of post-conflict economic reconstruction.

Concluding Remarks

War-torn, politically unstable, insecure, mismanaged, and destitute societies have been expected to become overnight liberal democracies with free-market economies pursuing optimal or first-best economic policies. This was expected of them despite the fact that they mostly lacked the basic requirements for free markets to work efficiently and that laissez-faire policies would deprive them of the necessary government support to survive in the immediate term.

But the record speaks for itself. Efforts to transform war-torn countries overnight have indeed been disappointing and costly—roughly half of the countries that transitioned to peace after the end of the Cold War relapsed into conflict within only a few years. Of the half that managed to keep a tenuous political peace, the large majority ended up with an unviable economy and a large dependency on foreign aid.

Experience with failed interventions that took place over the last quarter of a century provides strong evidence that post-conflict economic reconstruction is fundamentally different from normal development. Conflating the two has been a major factor behind the poor record. A change in strategy is urgently called for.

This experience has also provided evidence that, irrespective of how wars or chaos end, and despite the peculiarities of each particular case, there are nevertheless a number of commonalities with respect to the timing, the sequence of economic policies, and the three different but interconnected paths to be followed. These include the path from the economics of war towards normal development through effective economic reconstruction—an intermediate phase whose main objective should be to avoid a relapse into conflict even if optimal economic policies are not possible or even desirable; the path towards dynamic growth in the long run through inclusive policies that in the short run could improve security and the lives and livelihoods of the large majority of the population—even if only at subsistence levels; and the path towards fostering inclusive capitalism and self-reliance through increased foreign direct investment and exports—by creating incentives for investors and local communities to work together in 'win-win' projects that could lead to improved security, stability, and prosperity for all.

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