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MEMORANDUM

*Workshop on the Impact of Economic Policy for Recovery and State-building in
countries emerging from war - 3-4 April 2008*

The Graduate Center, City University of New York

Context

In the early 90s, shortcomings in the implementation of the peace agreements in El Salvador were a reminder that in countries emerging from war, the economy matters. Focusing mainly on institutional reforms in the security sector and on the reintegration of former insurgents, the accords required resources that the State did not have or was reluctant to obtain through special fiscal measures. A widely quoted article of the time noted that the political arm of the UN, which had brokered the accords, should have worked hand in hand with the IMF and the World Bank¹.

International interventions have since increased in numbers and complexity, often becoming more intrusive and broader in scope. Large flows of assistance from bilateral and multilateral sources have been allocated to strategies designed to lay the ground for durable peace. The donor community has become more involved and organized, and international financial institutions have developed their own expertise on post conflict situations. In 2005 the UN General Assembly approved the Peacebuilding Commission to steer and give coherence to international efforts in the post-conflict phase.

And yet, the experience of economic and aid policies in countries emerging from war exhibits a mixed record.

¹ See de Soto, Alvaro, and Graciana Del Castillo

The conceptual debate

Several terms seek to define external assistance to consolidate peace in countries that have been ravaged by war, but a common understanding as to their meaning and scope seems to be missing. State-building, stabilization, recovery, reconstruction, state reform, and post-conflict peace-building are often used interchangeably. A possible approach to bring some clarity to the discussion would be to look at the agent that originates the action and identify its goals, and then to measure success against the latter².

State-building is often used in the context of interventions launched in the wake of state collapse due to internal warfare or external attack. Military coalitions or multinational forces seek to create a new or fundamentally reformed state, modeled after the Western liberal tradition, underpinned by a new constitution and body of laws and espousing a market economy. They are ready to use force to achieve stabilization, on the understanding that this will permit recovery and reconstruction (comprising physical infrastructure and institution-building) to take place.

Institutional reform and democratization describe the more limited goals of many international operations often deployed in countries where a state structure or a central government are in place, and some level of local consent for the international presence has been obtained. Their goals may include the promotion of institutional reforms in the areas of security, rule of law and elections. Their use force is restricted to self-defense and, sparingly, to protect civilians in compliance with their mandate. Aid or assistance programs for peace-building activities from international, regional or bilateral donors are run separately, usually within the framework of a coordination mechanism.

For the purposes of a discussion on the impact of external assistance to war-ravaged countries, reference may also be made to large flows of bilateral assistance to

² This approach leaves aside the question of whether the goal itself should be questioned

governments facing internal conflict, organized crime (or a combination of both) not in the context of an international intervention. Such is the case of the US Plan Colombia, which has turned the South American country into the fifth recipient of US military aid worldwide. While its main goal is to eradicate drug trafficking, rather than reconstruction or recovery, it also seeks to restore state authority in areas of the country under the control of insurgents.

Matching expectations to results

Let us take a look at the example of Kosovo.

In 2002, an IMF report called Kosovo “a laboratory of economic institution-building from the ground up”. Six years on, as the territory goes through the threshold of independence, the experiment shows serious shortcomings:

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- The country does not yet have a viable economy. (It is estimated that 20% of its GDP still depends on external assistance)
- Unemployment stands at a level of nearly 50%, hitting particularly hard the population below 25, which makes half the total
- Poor physical infrastructure and inadequate supply of electricity continue to hinder economic growth and affect living standards
- Institutions remain weak
- Notwithstanding repeated commitments to a multi-ethnic Kosovo, little progress has been made in improving the integration and welfare of minorities. This affects the Roma in particular, and may have perpetuated Serbs’ reliance on allocations from Belgrade.

Meanwhile, the recent declaration of independence without the consent of the Serbs has resulted in the latter’s withdrawal from public institutions, raised troubling questions

about secession in the North and could put at risk Kosovo's prospects of profitable exploitation of its mineral resources.

What went wrong? Gaps and Contradictions

Drawing mainly from the experience of Kosovo, with occasional references to other cases, below is a list of observations on the contradictions and gaps in international economic and aid policies and practices which seem to undermine the overarching goals of democratic state building.

While it can be misleading to extrapolate from the specific circumstances alluded to in the questions listed, they contain points that may deserve further analysis and benefit from a review of policies and an improvement on current practices.

- More systematic, in-depth knowledge of the socio-economic conditions underlying conflict would help to decide on the most appropriate intervention policies and the best option for economic assistance. As the poorest region in Former Yugoslavia, Kosovo had received considerable flows of capital and subsidies from Belgrade before it suffered massive disinvestment in the 80s. The drastic reduction of assistance from the capital was crucial to subsequent events. It led to a growing wave of immigration, fueled the ethnic confrontation, which led to violence and repression and gave renewed impetus to aspirations for statehood from the population of Albanian ethnicity, as the Yugoslav Federation dismembered in the wake of successive national wars. Yet, these facts were largely ignored in defining international economic and aid policies at the time of the intervention.
- Confirming the observation above, insistence on macro-economic stability modeled after the richest market economies ignored the need for a multi-layered transition strategy (from war to peace, from a centrally planned to an open market economy and from life-long social security to individual competition). The

Humanitarian Pillar was dissolved barely a year after the NATO bombing campaign, and a much-needed welfare program was severely under-funded when established and therefore unable to meet essential needs, particularly among the most vulnerable sectors of the population: the rural poor and the minorities. This affected the credibility of international administrators and may have strengthened the Serbs' ties to Belgrade.

- Much of the foreign money sent to Kosovo went to housing and consumption needs, but failed to create a productive economy. The lack of much needed foreign investment was blamed on the delay in defining the final status. Today, there should be a realistic assessment of Kosovo's potential for growth. According to several sources, Kosovo could reduce its current dependency on funds from abroad (both as assistance flows and remittances) by exporting coal-based energy and minerals (zinc and lead) to neighbouring countries. This would require foreign (EU) investment to modernize the mining sector. Investments in physical infrastructure and electricity would also be needed.
- Kosovo's high unemployment rate among the young is a source of frustration that could result in violence. A modernized mining sector would be a welcome source of income, but would not be labour-intensive. Traditionally, self-subsistence farming, though inefficient, has been the source of work for the majority of the population. The feasibility of job creation through investment in the agricultural sector, with the EU as the main source of funds should be examined. More flexible policies from European countries in opening their labour markets would also help to absorb part of the surplus workforce.
- While remittances from Western Europe have dwindled, they still constitute a fundamental source of income for rural families, who use them mainly for consumption, to improve their homes and to buy tractors. It may be worthwhile to give incentives to projects that channel part of the money to community-based

productive activities with the participation of local institutions. This would also be a way of constructively engaging the diaspora in this phase of the process.

- Irregularities in the bidding processes for the allocation of works or for the operation of certain facilities or services gave rise to criticism and were used to discredit the international presence. The selection of foreign contractors for building physical infrastructure or providing public or private services should be guided by local needs, with clear technical criteria adapted to the local conditions and avoid the perception of favouring special interests. Adequate capacity-building should enable local personnel to take over responsibilities for running the operations as early as feasible. Appropriate auditing policies should become a practice in all cases.
- The informal economy deprives the State of needed resources, can result in maintaining exploitative labour conditions and provide a cover for groups engaged in illegal traffic. According to some observers, without the necessary support and strong assistance in gathering intelligence and fighting crime, Kosovo could easily become a haven for criminal organizations from the East.
- Excessive reliance on NGOs to channel assistance may undermine the stated goal of developing strong, efficient and accountable state institutions. It can also be a way of favouring certain groups that use the NGOs as a cover for their own political ends. In Haiti, President Preval reportedly remarked that international assistance to NGOs from some of the major donors outweighed the State budget by far.
- In addition to resolving pending economic issues with Serbia, Kosovo should be encouraged to open opportunities for mutual gains through trade and joint ventures with Serbia and other neighbours.

- A projection of economic trends would help to identify the recipient country's future possibilities to grow and give its population opportunities to enjoy the "dividends of peace" in a realistic way. This would have been helpful in El Salvador, where future stability relied to a large extent on an effective economic reintegration of ex-combatants from both sides. A program for the transfer of land provided an immediate way out from a dangerous political stalemate. By the end of the war, however, the farming sector had been affected by volatility in prices and declined in importance. While the program raised high expectations among beneficiaries and was perceived as a response to a political and social need, technical assistance for the exploitation of the transferred lots was inadequate even for subsistence farming, and the program became largely unsustainable in the long run.
- Also in El Salvador, to achieve meaningful economic reintegration in the agricultural and other fields, special financial and technical resources should have been made available by the State with the support of international agencies and donors. This would have required engaging the sectors with the highest levels of income, who would benefit most from the end of the war, through a raise in fiscal revenues. Accountable, though flexible allocation policies should have been explored and applied to the extent possible.