Conflict, Postwar Rebuilding and the Economy: A Critical Review of the Literature

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Preface

Economic aspects and issues are obviously at the heart of efforts to rebuild war-torn societies and consolidate peace in countries emerging from years of civil war. Yet relatively little attention has focused on these issues in popular media as well as in the specialized press. This may be due to the fact that questions of humanitarian relief and the politics of peace-keeping have been in the limelight of public and political interest. It may also reflect the fact that economists, and the main institutions of economic development and finance, have long been uneasy and ambivalent about focusing directly on these issues and getting involved in complex and often messy post-war situations.

While the academic literature on these questions has remained relatively limited, assistance to economic reconstruction and rebuilding of post-conflict societies has rapidly become a major preoccupation of bilateral and multilateral development agencies. There is thus a clear gap between the theory and practice in this field.

The present study represents an important piece of work as it offers for the first time a thorough and critical review of the economic literature on post-conflict rebuilding. It identifies the shortcomings of present literature in the light of practical experience and exposes the limitations of neo-classical economics. It shows how difficult it is for traditional economists to take into account the complex and essentially political and irrational factors that determine individual and collective behaviour in these situations. The author shows how crucial it is to assess economic policies not only in the light of their economic viability and effectiveness, but also, and often more important, in the light of their impact on conflict and peace. He shows how the reality of complex post-conflict situations calls for more integrated holistic approaches and thereby fundamentally questions established paradigms of economic analysis and praxis. The study will thus be of interest to practicioners and scholars alike.

The author is a Swiss economist who has acquired first hand experience in war-torn countries, working with the ICRC in relief and humanitarian action in countries such as Iraq, Ethiopia and El Salvador as well as with the UN and the OSCE in election monitoring in countries such as Bosnia-Herzegovina and Mozambique. The author has also been actively involved in the field of trade and development with the Swiss Federal Office for Foreign Economic Relations, thus gaining practical insight into various aspects of economic and development policy, as well as external assistance from a donor's perspective.

The present study is not part of the War-torn Societies' main project core activities which consist of experimental action-research processes in selected war-torn societies. It is primarily a contribution to the author's doctoral dissertation on post-conflict rebuilding in Guatemala, which the author carries out in association with the War-torn Societies Project (WSP). In this context, the study draws on some of the findings and preliminary lessons emerging from several of WSP's thematic working groups which focus on the socio-economic framework of reconstruction in Eritrea, Guatemala and Mozambique.

The WSP would like to take this opportunity to thank the many bilateral and multilateral agencies and foundations that support the project's work Particular thanks go to the Carnegie Foundation of New York which has given a special grant towards the completion of this study which should be of interest to practitioners and scholars alike.

Matthias Stiefel, Director, War-torn Societies Project

Executive Summary

Contemporary conflicts do obviously not fit into the former conceptual framework of bipolar confrontation. The overwhelming majority of today's conflicts affect low-income or low-middle-income economies and take the form of protracted internal struggles that sporadically erupt into violence. Former peace economics - with its primary focus on arms race and defence expenditures, and its strong reliance on games theory - is therefore of limited help in meeting the complex challenges facing contemporary war-torn societies.

The objective of this paper is to provide a critical overview of the economic literature on conflicts and postwar reconstruction since the end of the Cold War. Despite the enormous human and economic costs of war in the developing world, the contributions of economists to research in this area are still surprisingly sparse and limited, even if commitment to remedying this has been increasing. It is true that economic research on war-torn countries runs into particular methodological difficulties. Substantial effort and innovative approaches are thus required to cope more effectively with the challenges of socioeconomic rebuilding.

Although this paper focuses on postconflict rebuilding, relevant literature on the socioeconomic root causes of war and the impact of conflict on the economy is also included. For isolating the chronological sequences "before-during-after conflict" in order to study contemporary war-torn economies can be misleading. Formal peace agreements do not necessarily imply a gradual return to normality, as fragile peace may easily be impaired by recurrent violence. In this context, war causes often persist during the reconstruction phase and must be carefully taken into account.

This review highlights the implications of war and postconflict rebuilding for a wide range of economic policies, and then identifies and assesses major debates and controversies among scholars in this area. The main recommendations emerging from the literature are discussed, with particular attention devoted to *potential contradictions between economic reform, external assistance, and peacebuilding agendas*. Reviewing research on recent postwar experiences further reveals that *there is no blueprint for rebuilding war-torn economies*. The specific circumstances of each country must be carefully analysed and the rationale behind every conflict properly understood if appropriate rebuilding strategies are to be worked out.

The author concludes that some of the most *fundamental aspects of postconflict rebuilding have been overlooked*, mainly because they do not fit into the prevailing paradigm. Some of the basic assumptions underlying traditional economic theory (e.g. rational economic behaviour of individuals) are starkly contradicted by the reality of war-torn societies. This paper argues that *political stability cannot be relegated to a lower priority than - and should actually prevail over - economic efficiency when designing postconflict policies*, for reconstruction activities are nullified if war starts anew. By the same token, efforts to restore the necessary confidence among investors and consumers to restart economic activity cannot succeed without a minimal level of stability and predictability.

Taking such key factors into account requires from economists to take a broad, global perspective on postconflict reconstruction. This paper thus reviews research on institutional and political challenges related to postconflict rebuilding. For economic analysis cannot simply ignore these dimensions or take them for granted in highly sensitive postwar contexts. More specifically, this review draws on recent conceptual advances in the fields of political economy and new institutional economics, and further includes a section on the interactions between the processes of economic development and peacebuilding.

Suggestions for future research with a view to improving our understanding of - and capacity to cope with - economies at war and postconflict reconstruction include the following:

Systematically assess the distributional impact of postwar economic policy, as shifts in the balance of power and entitlements play a critical role in the restoration of peace or the renewal of violence. Intensify research on the political economy of postconflict rebuilding and on the role of major actors involved in policy making. Draw on the new institutional economics to better understand the interactions between economic reforms, institutions, and conflict. Develop innovative approaches to cope with the alarming process of economic regress and state failure that has already led to the eventual collapse of public services and institutions in several war-torn countries. Deepen multidisciplinary research by integrating the concepts, models and paradigms from other disciplines into economic research on countries at war and postconflict rebuilding.

I. Introduction

A European economist who served as an adviser to the Rwandan Government from 1990 to 1994 was later invited to assess his performance in retrospect of the 1994 Genocide. He insisted on the fact that his advisory job in Rwanda was strictly confined to macroeconomic issues. Although he was fully aware of the gravity of ethnic tensions and knew that conflict could burst out again at any time, he admitted that these issues were never discussed nor referred to in the framework of his mandate. As soon as violence flared up in April 1994, he left Rwanda to go back to his capital, transmitted his files to other colleagues in charge of humanitarian and political affairs, and was then assigned to a similar position in another developing country. This example reflects the dramatic lack of expertise and/or commitment among economists to cope with the complex challenges of highly conflictive situations, and to contribute to the transition from war to lasting peace.

All major regions of the developing world have been plagued by civil wars or regional conflicts since the end of World War II, with low-income and lower middle-income countries being particularly affected. Stewart *et al.* (1997: 14) calculate that the incidence of conflicts in which more than a thousand people died in any given year between 1960 and 1990 was 60% and 52% among low-income and lower-middle-income countries respectively, compared with "only" 35% among upper-middle-income countries. Contemporary conflicts do not conform to traditional images of battlefields. According to Smith (1993: 1-3), only 3 out of the 79 nations that experienced widespread political violence in 1993 were industrial countries. Around 90% of the victims (casualties, wounded and displaced persons) were civilians. More than half of these conflicts have lasted for over a decade, often taking the form of intermittent warfare that erupted only from time to time. Internal war has become the rule rather than the exception: the 1996 SIPRI Yearbook highlights that all thirty of the major wars in 1995 were conflicts within a state.

These recent conflicts have taken a massive toll of human lives and livelihoods. They have been indicated as both a major source and consequence of underdevelopment. Until recently however, the overwhelming majority of economists and development agencies tended to consider war an external event, not amenable to economic analysis, "which disrupts from time to time more normal conditions under which economic laws apply" (Fischer and Schwartz, 1992: 239).

The bipolar structure of the global political system in the Cold War era contributed to overshadowing - or in some cases to impairing - potential efforts by humanitarian and development organisations to strengthen peace and rebuilding processes in developing countries. Since 1989, however, the international community has devoted more resources to peacebuilding and reconstruction activities. While there has been a continuing stagnation or fall in official development aid (ODA) provided by OECD countries, with a drop in aid flows as a percentage of GNP from 0.34% in 1989 to 0.27% in 1995, funds allocated to relief, peace-keeping, and reconstruction grew tremendously after the end of the Cold War to reach an average annual expenditure of US $8-10 billion in 1993-1996[1]. The share of non-food emergency aid alone in total ODA increased from 2.1% to 4.5% between 1989 and 1994[2].

Over the last few years, some economists in academic circles have begun to undertake research on conflict-ridden economies and on the complex challenges of rebuilding war-torn countries. Multilateral institutions and bilateral agencies have also been making efforts to better understand and effectively assist these countries. From 1992 onwards, humanitarian and development circles have been engaged in a wide debate to establish a more effective and coherent framework for relief, rehabilitation, and development activities (Stiefel, 1994; UNDP, 1994 and 1995). In 1996/97, the World Bank worked out a policy paper for its involvement in postconflict reconstruction and decided to establish a "Postconflict Unit" to respond to the needs of its operations in conflict and postconflict situations (World Bank, 1997a). The Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD/DAC) has been working on the formulation of policy orientations for development co-operation in conflict-prevention and postconflict recovery. The resulting guidelines were endorsed by DAC members at the May 1997 High Level Meeting in Paris (OECD, 1997). These guidelines provide valuable indications on the latest, collective views and commitments of donor countries on ways in which the international community should address issues such as conflict prevention, peacebuilding and reconstruction.

The main aims of these recent endeavours by scholars and the international community are to: analyse the root causes of conflict, design appropriate preventive strategies (e.g. early warning systems), and assess in particular the relationship between economic policy and political violence in order to design economic policies conducive to peacebuilding and stability; understand the effects of war on the economy, with a view to mitigating its costs to society and improving the prospects for early reconstruction; understand the various challenges of rebuilding postconflict economies, so as to promote a successful transition from war to lasting peace and sustainable development; last but not least, integrate the complex, multifaceted issues involved in the transition from war to peace into a strategic and coherent framework, and assess the interactions between external assistance, conflict, and reconstruction with a view to improving the impact and effectiveness of external assistance.

I.1 Objective and Structure of the Paper

The objective of this paper is to provide a critical review of recent *economic literature on conflict and postwar rebuilding*. As argued below, earlier economic research on conflict and peacebuilding no longer provides an adequate analytical framework. This review therefore concentrates primarily on research conducted since the end of the Cold War, with a focus on current postconflict countries, i.e. mainly low-income and low-middle-income economies affected by internal conflict.

The paper is organised by thematic areas and aims to highlight ongoing debates and controversies emerging from the literature. It deals in particular with research on the relationship between economic policy and peacebuilding. This paper is a "critical" review to the extent that the author (i) assesses strengths and weaknesses of recent research on conflict and reconstruction at the end of several thematic sub-sections; (ii) draws on wider sources rather than strictly limiting itself to traditional economic research areas; and (iii) provides an overall assessment of the literature in the concluding section, indicating areas for future research.

Although the focus of this paper lies clearly on postconflict rebuilding, the author felt necessary to include a section on the socioeconomic root causes of wars, as well as on the impact of conflicts on the economy. For the concept of "relief-rehabilitation-development continuum" is inappropriate and can be operationally misleading in that it implies a linear sequencing from acute conflict to peace, and then to postconflict rehabilitation and long-term economic development (Stiefel, 1994: 16-17). In fact, many contemporary conflicts do not follow any set chronological pattern. Recent studies have highlighted that relief, development, economic and politico-military actions are often simultaneous processes. Formal peace agreements do not necessarily imply a gradual return to normality as a fragile peace may easily be disrupted by recurrent violence. Nowadays, there is little agreement as to the point when conflict comes to a definitive end (King, 1997:19-23).

Consequently, the distinction between preconflict, war, and postconflict situations is ambiguous and should not serve as a criterion to limit the scope of research on economic rebuilding. Hence, socioeconomic research on the causes and impacts of conflict is generally included in this paper under the relevant chapters on postconflict rebuilding, except for section II, which deals specifically with the dynamics of economies at war and the distributional effects of conflict. The structure of the paper is therefore as follows:

The remaining part of the introductory chapter outlines the thrust of economic research on conflict and reconstruction from 1945 to the end of the Cold War. It then highlights the methodological difficulties in studying contemporary war-torn economies and provides conceptual clarification on key terms used in the literature. The second section concentrates on economies at war: it focuses on the impact of war on the economy and its distributional effects on different households and social groups. The fundamental dynamics underlying contemporary civil-war economies are also discussed. The third and central section of the paper reviews recent contributions on the socioeconomic aspects of postconflict rebuilding. Particular emphasis is given to current debates on (i) economic policy, structural adjustment, and the consolidation of peace; and (ii) external economic assistance and the role of the international community. The fourth section draws on relatively new research areas to help provide a wider perspective on economies at war and peacebuilding. It focuses especially on (i) the political economy of postconflict reconstruction; (ii) the institutional challenges of rebuilding war-torn countries; and (iii) the relationship between economic development and peacebuilding. The fifth section discusses the main suggestions and policy recommendations that have been presented in the literature. The concluding section provides an assessment of the literature. It then highlights the weaknesses of economic research on postwar reconstruction and suggests methodological approaches and topical areas where further research would contribute to a greater understanding of - and capacity to cope with - the complex challenges of socioeconomic rebuilding.

I.2 Research Focus from 1945 to the End of the Cold War

During the Cold War, "peace economists" were primarily concerned with issues linked to East-West confrontation, such as the strategic balance between the two superpowers, the arms race and arms control, impacts of defence expenditures, conflict management analysis, etc. Extensive use was made of games theory which was originally developed by Von Neumann and Morgenstern in 1944 to explain economic behaviour and to analyse conflicts and their resolution. Anderton and Isard (1992: 1-55) produced a concise survey of the main strands of thought in the literature on peace economics during the Cold War. It focused on the following issues: standard resource allocation analysis and strategic behaviour (games framework); arms race models; analysis of military expenditure impact on macroeconomic stability (Keynesian and general equilibrium framework) and disaggregated (micro-) analysis of defence spending; impact of military outlays on investment, productivity and growth (endogenous growth); political economic analysis (e.g. pressures from the military industrial complex on the governments).

As concerns economic analysis on postconflict reconstruction after World War II, much research has focused on the Marshall Plan, which still represents a milestone in the field of the economic rebuilding. However, most of the lessons drawn from rebuilding Europe after 1945 do not apply to contemporary postconflict countries. As Lake points out (1990: 10-17), there are probably more differences than similarities between the challenges of European recovery after 1945 and the plight of war-torn societies in the developing world at the end of the twentieth century. The author makes the following points:

The challenge of Third World nations is often to build basic infrastructure and create new capacities, whereas European countries had the remnants of an extensive physical infrastructure, as well as political and entrepreneurial traditions conducive to growth and stability. One might add to Lake's analysis that literature on contemporary conflicts reveals that the differences in agenda between donors and recipients are often larger today than they were between the United States and Europe after World War II - not to mention differences in cultural ties and values. The military victory of the Allied Forces was undisputed, and peace could be firmly restored, whereas the main challenge facing many postconflict countries today first consists in restoring a minimal level of security and stability. Although Europe itself accounted for 80% to 90% of the capital formation during the first two years of the Marshall Plan, the American contribution was immense, amounting to US $13.2. billion from 1948 to 1951 (equivalent to some 80 billion in 1996 US dollars), or 2.5% of the recipients' GDP. The repetition of such a large contribution seems unlikely in the context of budgetary constraints and diverging political agendas among donor countries. In addition, the ability of local governments and other domestic institutions to make the best use of foreign assistance is much smaller in low-income postwar countries nowadays, their absorptive capacity remaining sadly limited.

Economic analysis of developing war-torn countries has indeed been rather rare. In a seminal book on *The Industrialisation of Backward Areas*, Mandelbaum (1945) made one of the earliest studies dealing with the reconstruction of non-industrial countries, i.e. backward areas of eastern and south-eastern Europe "which were left virtually untouched by the vigorous industrial development of western Europe in the nineteenth and twentieth centuries". The author selected this region partly because information about conditions in this part of the world was slightly more plentiful than that dealing with other less advanced areas. However, only pre-World War II material was used and no account was taken of the changes in the region since 1939. Consequently, the book deals more with the process of industrialisation of backward pre-war economies than with the reconstruction of postconflict countries, even though this enquiry was part of a wider research project on problems of international reconstruction. The book by Bonné (1945) on *The Economic Development of the Middle East* is another early reference on postwar reconstruction in the developing world.

For certain researchers however, specific features of the Marshall Plan may commend themselves to contemporary planners of reconstruction programmes. Lake (1990) particularly stresses the necessity to rely on local planning and initiative, and the advantages of adopting a regional rather than national perspective to reconstruction. De Long and Eichengreen (1991) argue that the major contribution of the Marshall Plan to European recovery was not financial aid itself, but rather the conditions attached to it: aid was granted provided recipient governments made a commitment to keep budget and inflation under control. In addition, the Marshall Plan strongly encouraged recipient governments to deregulate the postwar economy and make greater reliance on market mechanisms[3]. De Long and Eichengreen nonetheless recognise that the Plan did play a major role in alleviating resource shortages. The massive inflow of financial aid facilitated the implementation of sound economic policies by reducing the costs of adjustment to be borne by competing distributional interests: "It did not obviate the need for sacrifice. But it increased the size of the pie available for division among interest groups." (p. 45).

But even if specific lessons from the past may still apply in the case of contemporary conflicts, many economists have recently questioned whether traditional research on war and peacebuilding can still provide an adequate analytical framework after the rapid disappearance of the bipolar structure of the global political system (e.g. Van de Goor *et al.*, 1996: 1). While the end of the Cold War may have contributed to establishing peace in some countries formerly caught under the logic of bipolar confrontation, it has also created opportunities for new eruptions of violence. In addition, a number of protracted conflicts did not disappear, proving to be deeply rooted in local circumstances rather than being mere by-products of East-West rivalry.

I.3 Methodological Challenges Related to Contemporary War-torn Economies

The study of contemporary war-torn countries poses major conceptual and methodological challenges, which may at least partly account for the paucity of economic research on developing countries at war. Economists have identified the following as being the most important:

Probably the major methodological challenge for traditional economic research is the difficulty of conducting solid empirical analysis because of an acute lack of reliable data on conflict-ridden economies. This partly reflects the weakening of government capacity to collect and process data during hostilities. It might also be because accurate socioeconomic data on income and asset distribution would be considered counter-productive or even dangerous by a government under attack. Besides, the information available often fails to include the informal, illegal and criminal activities that tend to flourish during conflicts. In the case of the Horn of Africa, for instance, survival strategies have increased the share of subsistence agriculture in the overall economy and growing informal or underground sectors have pushed a considerable portion of economic activities outside the scope of national accounts (Brown *et al.*, 1992: 195-209).

Traditional microeconomic assumptions on economic behaviour may not apply under conflict conditions, confirming a need to resort to a wider, interdisciplinary approach to understand the behaviour of individuals and groups. Political science, anthropology, and other social sciences are obviously essential in efforts to identify the multifaceted aspects of war and postconflict reconstruction, while economic analysis itself, according to FitzGerald and Stewart (1997: 5), can contribute to understanding the conditions under which actors make decisions, and then how the consequences are transmitted to society as a whole.

A third problem is distinguishing socioeconomic changes that can be attributed solely to the war from effects caused simultaneously by other factors (e.g. changing international terms of trade). Counterfactual analysis might provide some assistance, but is even more difficult to carry out than under normal circumstances: first, pre-war economic conditions are often radically altered during the conflict; second, comparison with similar countries at peace is questionable since differences in initial economic conditions may actually account for the emergence of a conflict in the country under analysis; and third, data deficiencies make economic modelling of war-affected countries very difficult, if not impossible in some cases (Stewart *et al.*, 1997: 22). Nonetheless, applied research and empirical analysis are required to improve our capacity to mitigate the costs of conflict and better contribute to postconflict rebuilding.

Economies at war do not lend themselves to simplistic generalisations as each and every conflict-ridden economy has its own characteristics. Researchers have nonetheless attempted to find common features among countries at war so as to be able to assess better the likely effects of conflict on the economy as well as to design appropriate responses.

Another problem is that there is no such thing as *a typology* for the analysis of conflict economies, and the lines between situations of widespread violence, civil disorder, and conflict have become blurred. Scholars have selected and categorised wars according to different criteria (e.g. causes of conflict, kind of actors involved, number of battle-related deaths, degree of state regression or collapse, etc.) depending on the purpose of their research, which makes cross-study comparison difficult. For example, Stewart *et al.* (1997: 12) consider conflicts in which more than 1,000 people died in a given year as a direct or indirect outcome of the fighting to assess the costs of war. In another study on war and development, Smith (1993: 5) takes into account all conflicts having inflicted a cumulative number of casualties of several hundreds and in which more than 25 people were killed in a given year. Nafziger (1996) identifies countries with at least 2,000 war casualties in 1992-94 or at least 100,000 internally displaced persons in 1995 to analyse the economics of complex humanitarian emergencies.

But one may argue that the greatest challenge may in fact lie elsewhere: During civil war as well as in its direct aftermath, politics tends to take precedence over economics. Questions such as how socioeconomic factors affect the structure and balance of power between all actors involved are crucial in understanding the rationale and behaviour of capital and land owners, peasants or urban workers, investors, consumers, etc. Based on the literature review, this paper contends that what is needed may be more than a mere interdisciplinary perspective. Economic analysis of countries at war and postconflict rebuilding requires a paradigmatic shift so as to integrate fully fundamental issues such as political stability and institutional capacity for peaceful conflict management. In the concluding section, it is questioned whether the conceptual framework of traditional neoclassical economics is appropriate for addressing some of the most fundamental issues related to postconflict rebuilding.

I.4 Conceptual Clarification

This sub-section aims to clarify key concepts used in literature on conflict and reconstruction. It briefly summarises some of the rare definitions provided in the literature under review and shows how several authors have given different meanings to the same concept.

Stiefel (1994: 15-17) describes *disaster* as the result of a breakdown of an equilibrium (economic, nutritional, socio-political, ecological, or a combination of these) within a social group. The breakdown of one equilibrium in a given sector often affects other areas and creates a *complex or compound emergency*. The relative strengths and weaknesses of people's coping or survival mechanisms depend on past development strategies and policies, or the pre-disaster situation. *Emergency relief* involves immediate and short-term survival assistance to the victims of violent conflict (OECD, 1997: 11).

Internal war is defined as any conflict where there are two or more major groups fighting within a country or part of it, even though other countries may also be actively involved (Stewart et al, 1997: 12). Such conflicts can take the form of conventional battles or prolonged guerrilla warfare, and are also referred to as civil war.

The *transition from war to peace* encompasses the period between the cessation of hostilities and the establishment of political and socioeconomic "normalcy", when some semblance of political order and stability has been restored and most of the terms of the peace accords have been (or are being) implemented (Kumar, 1997: 2-3). *Peacebuilding and reconciliation* focuses on long-term support to viable political, socioeconomic, and cultural institutions able to address the root causes of conflicts and establish the necessary conditions for peace and stability.

Conceptual clarification between *rehabilitation* and *reconstruction* has been subject to discussion. Some authors have argued that while reconstruction refers to the repairing of physical and social infrastructure, rehabilitation deals with the restoration of entitlements of crisis-ridden people and households. The term *rebuilding* then often encompasses both rehabilitation and reconstruction. But for other experts, *rehabilitation, reconstruction,* and *rebuilding* can be used interchangeably and refer to efforts by domestic and international actors aimed at rebuilding the political, economic, and social structures of war-torn countries[4]. For Moore (1996: 15), "recovery assistance should serve the transition between emergency assistance and longterm economic development" and should help create a facilitating environment for local people. The formidable tasks associated with the socioeconomic aspects of recovery co-exist with humanitarian, security and political components and are mutually interdependant.

Referring to complex emergencies and postconflict rebuilding, the term "*international community"* usually refers to multilateral and bilateral agencies, intergovernmental organisations, international non-governmental organisations (INGOs), relief agencies, and sometimes private firms, involved in emergency relief, rehabilitation, and development operations (Ball, 1996: 13; Kumar, 1997: 3).

The concept of *reconciliation* has hardly ever been defined or explicitly referred to in economic studies on postconflict rebuilding. It is nonetheless crucial for the successful reconstruction of war-torn societies, as will be argued in this paper. For reconciliation implies the restoration of (i) a minimal level of trust and confidence between former enemies; (ii) the capacity to peacefully co-exist, interact and compete for resources; and (iii) peaceful dispute settlement mechanisms. Galtung (1995) refers to the three R's, i.e. conflict resolution, reconstruction and reconciliation, and argues that the three components should be approached together. He adds that neglecting one of them inevitably puts the whole peace process at risk. He further suggests that conflict parties should reconcile by working together on resolution and reconstruction. During a meeting held in Geneva in October 1997, the South African Finance Minister A. Erwin also insisted on reconciliation as a key factor: he stated that economic research on - and advice to - his country should stop focusing strictly on macroeconomic issues as the future economic development of South Africa depends first and foremost on successful reconciliation and a greater capacity to manage conflict in a peaceful manner. Reconciliation should thus be added to the list of key concepts above.

1 Aggregate donor expenditure on humanitarian emergencies peaked in 1994 (Bosnia-Herzegovina, Rwanda). Between 1993 and 1996, it has averaged over US $3 billion in bilateral aid, over US $2 billion in multilateral aid, and over US $3 billion in annual military costs (OECD/DAC press releases on aid and other financial flows, 1995 and 1996). Military expenditure on peacekeeping activities does not count as ODA, but represents an additional contribution which has a considerable impact on economic development.

2 Source: OECD Development Assistance Committee, 1991 and 1996 reports.

3 The two authors note that conditionality was not necessarily felt as a constraint by the recipient European governments as the requirements imposed by the United States often matched their own objectives.

4 According to Kumar (1997), rebuilding efforts imply three essential and interrelated elements: (i) restoration of physical infrastructure and facilities, basic social services and government functions; (ii) structural reform in political, economic, social, and security sectors; (iii) institution building.

II. Conflict and the Economy

Systematic economic research on the interactions between war and the economy notably originates from Oxford University. Frances Stewart and E.V.K. FitzGerald have pioneered work on war costs in developing countries and have conducted horizontal studies on the effect of conflict on the economy. Thus, the first part of this section, dedicated to the interactions between conflict and the economy, focuses largely on the contributions of these authors.

In the framework of what may be the first cross-country empirical survey of this type to date, Stewart *et al.* (1997) assess in particular the economic effects of war for some sixteen countries affected by major conflict in the 1970s and 1980s, in which over 0.5% of the population died as a direct or indirect result of war. This survey is based on the socioeconomic data available on these economies, mainly from the World Bank's *World Development Reports* and *World Tables*. However, it should be remembered when reviewing such data that statistical surveys on war-torn economies are as reliable as the data available on such countries (see section I.3 above). Besides, they generally neglect large economic sectors of countries at war such as informal and illegal economic activities, barter trade, consumption of own subsistence production, etc.

Bearing this in mind, the cross-country survey by Stewart *et al.* confirms, as one would expect, that GDP growth rate and income per capita tend to be negatively affected by conflict. The authors conclude that even if the most visible effects of war hit the economy directly through damages to physical and social infrastructure, the indirect effects may have more dramatic implications for long-term development. More specifically, the social and cultural disintegration of war-torn societies has a dramatic impact on the economy: in the absence of minimal political stability, mutual trust, and respect for property and the rule of law, economic relations break down (see also Stewart, 1993). This in turn may have multiplier effects on the fall of domestic production and income. Thus, most human misery and deaths in poorer countries are not a result of direct violence, but of the more general effects of protracted conflict on economic and administrative structures, such as the collapse of basic public services, famine and large-scale forced migration.

The next sub-section gives more details on the impact of war costs on living standards and on the distribution of these costs, i.e. who stands to win or to lose from the war. The following sub-section then analyses how civil war economies function and evolve. It is interesting to note that the fundamental dynamics underlying contemporary economies at war have been brought up and assessed by political scientists and humanitarian practitioners rather than by economists themselves.

II.1 War Costs

Methodologically, Stewart *et al.* (1997) extend Amartya Sen's original concept of entitlements (legally-based claims of households to the goods and services supplied by the market or derived from their own production) to assess how living standards are affected by conflicts. The authors introduce the notions of *public entitlements* (goods and services provided by the state), *civil entitlements* (production and transfers arising from the community and NGO sources) and *non-legal acquisition or loss* of assets and incomes arising from the conflict. They argue that the breakdown of the formal private and public economy is one of the major causes of decline in market entitlements, as originally defined (see for instance Sen, 1992). Yet, this decline can be countered by alternative forms of public and civil entitlements provided by emerging social networks and the burgeoning informal economy, or by rebel groups and/or humanitarian agencies. The emergence of alternative forms of entitlements generates winners as well as losers. Some groups may acquire a vested interest in the continuation of conflict as they draw substantial profits out of quasi-rents created by market shortages, or out of illegal and predatory activities encouraged by widespread impunity (FitzGerald and Stewart, 1997: 6).

The empirical results of this survey confirm that war costs appear to be more severe in cases of geographically pervasive conflicts where the government has lost its capacity to collect taxes and provide basic services. Where "quasi-government structures" were able to maintain core functions, these costs could be limited to a certain extent. The findings also show that international wars tend to have less harmful effects than internal conflicts, due especially to the fact that in the former case, the state usually strives to maintain basic social services throughout the country as part of its war effort.

Differing conditions in the nature of conflicts and of the countries in which they occur may explain why there are considerable differences between the consequences of wars. Stewart *et al.* (1997: 18-19) point to several factors that are positively correlated with the economic costs of war: (i) duration, magnitude and geographical spread of a conflict; (ii) imposition of a severe international trade embargo; (iii) public service and state collapse, and (iv) the lack of alternative support networks such as family, rebel forces or humanitarian agencies. The characteristics of the economy prevailing before the war also determine the extent of later war costs, particularly: (i) the initial import dependence ratio; (ii) the level of subsistence production in the country; and (iii) how near the poverty line or survival limit people were situated in the first place.

Winners and Losers

Recent studies have shown that war typically spurs radical changes in the allocation of resources and activities among sectors and institutions (primary income distribution) as well as among households and social groups (secondary income distribution). As a result, a small minority of people ("winners") often acquires a vested interest in the continuation of conflict, while the vast majority ("losers") slides toward, or below, absolute poverty line.

Stewart (1993) insists on the fact that famine results mainly from entitlement failure, falling income and breakdown in the distribution system, rather than from a drop in aggregate food supply. Household *survival strategies* are associated with the spread of parallel and extra-legal activities which might themselves provoke further tensions and the transfer of assets or population (Duffield, 1994: 50-69). Coping strategies often rely on "job diversification", that is a shift of household members on the labour market to ensure maximal liquid income and entitlements. Access to public entitlement and security may require a given household to maintain some of its members in the public sector or join the armed forces, while other members may emigrate to richer countries and send remittances. To the extent that soldiers and security forces are not adequately remunerated by the state, they have an incentive to resort to systematic corruption and looting to improve their own situation. Another survival strategy for some household members is to rely more permanently on foreign assistance. The most profitable, but most risky option is to engage in illegal activities. As a last resort, the most vulnerable groups may be forced to sell or pledge their subsistence and production assets such as land and livestock, or personal assets like jewellery, that other people ("winners") acquire at rock-bottom prices. Migration often remains the ultimate survival strategy (Stiefel, 1994: 16).

At the household level, FitzGerald (1997: 53) finds that the social group likely to be worst affected by war is the urban poor and landless who have less access to informal quasi-rents and fall outside the official welfare net. It is then largely the poor who are "paying for the war", especially if the increasing fiscal deficit is met by inflation rather than by an increase in taxation or external finance, as is often the case in conflict economies. Inflation may *de facto* help contain the real budget deficit by reducing the real wages paid by the government to public sector employees, but it severely affects their living standards. On the other hand, nominal revenues accruing from activities in the informal sector rise as prices increase. Therefore, households which enjoy wide access to quasi-rents resulting from supply shortages in the formal market are in a position to maintain entitlements, or even make substantial gains. But the growing number of petty traders in the urban informal sector benefit from rising demand for goods and services on parallel markets only to a limited extent as the labour supply rapidly increases in this sector and exacerbates competition. As for peasant farmers, they may benefit from higher food prices when selling their production but they also have to pay more for agricultural inputs. In short, FitzGerald (1997) concludes that the distributional effects of war on real income among households depend on internal terms of trade, consumption patterns, employment opportunities and real wages, as well as access to scarce resources.

Within households, war profoundly changes traditional gender relations as men are mobilised, wounded, or killed. Research on gender and conflict shows that women should not be seen only as war victims: they often acquire greater responsibilities and a more prominent role as household head and chief provider. Yet, it has been highlighted that households without male adults tend to be more vulnerable to loss of market and public entitlements such as food shortage or escalation in the prices of staple goods and basic services. (For further reference on gender and postconflict rebuilding, see Sørensen, forthcoming.)

II.2 Dynamics Underlying Civil War Economies

Statistical surveys on war economies and studies on survival strategies are useful contributions when coming to grips with peacebuilding and reconstruction strategies. However, one may argue that it is necessary to have a better understanding of the underlying dynamics of civil war economy in order to assess accurately who stands to win or to lose from conflict and peace, and why. Recent research offers promising first steps in this direction.

In their book on civil war economies (*Economie des guerres civiles*), Jean and Rufin (1996) adopt an original approach to contemporary armed struggles by analysing how internal conflicts are financed. In order to understand today's complex humanitarian emergencies and the recent evolution of countries at war, the authors analyse how conflicts affect the structure and organisation of the economy. For them, the economic analysis of civil war represents one of the most promising approaches to building a new theory about internal conflict (or counterinsurgency). They stress that in the aftermath of the Cold War, our conceptual framework must be updated to account for the increasing importance of local economies over foreign assistance, be it military and financial support or "humanitarian sanctuaries", i.e. refugee camps located in neighbouring countries.

As a result of falling foreign financial and military support, warring parties have to depend primarily on their own natural assets, i.e. exploiting and trading domestic resources such as tropical timber, rubber, mines, gems, as well as arms and drugs (see also Labrousse, 1996: 467-494). Consequently, fierce fighting is taking place in and around strategic areas as opposing groups try to secure territorial control over key resources and trading routes. Rufin (1996: 53-55) argues that the increasing fragmentation of armed groups is mainly the result of heightened internal struggles among parties in conflict to exploit and market local resources. Countries at war are then plagued by a surge in economic criminality and predatory behaviour. Rufin adds that in an environment of extreme scarcity, humanitarian aid is another resource that has been subject to increasing attacks in recent years. Finally, this author remarks that opposition groups have also increasingly appealed to their diaspora established in richer countries for financial support (see also Angoustures and Pascal, 1996: 495-542).

All these issues are fundamental in a socio-political perspective. But they should not be ignored by economists as they can greatly contribute to an understanding of the dynamics at work in civil war economies as well as in rebuilding processes. Surprisingly, it is non-economists such as Jean and Rufin who have recently brought up such basic questions as widespread criminalisation of the economy and international criminal networks, competition for the control over resources and trading routes, importance of economic survival strategies, role and impact of the booming informal sector, widespread corruption, etc. Although most economists tend to acknowledge the relevance of such fundamental factors in the rebuilding process, they tend to pay lip service rather than give them substantive attention. Therefore, serious attempts to integrate such basic issues into economic analysis and planning are still very limited. This gap may derive among others from paradigmatic and methodological difficulties related to economic research on contemporary conflicts. Filling this gap requires pioneering work in relatively new ground. Some suggestions in this direction are presented in the concluding section of this paper.

III. Postconflict Rebuilding

It is widely recognised that the objective of socioeconomic rehabilitation is not to restore the economy to what it was before the war, but to lay the foundation for lasting peace and sustainable development, so as to enable postconflict countries to draw maximal benefits from potential capacities. The reconstruction phase provides special opportunities for major political, economic, and administrative reforms as well as for the modernisation of production capacities. But economic adjustment is often in contradiction with political adjustment toward peace. Hence, development/relief institutions (e.g. ILO, OECD, UNDP, USAID, World Bank) and authors such as Lake *et al.* (1990) and Kumar (1997) have increasingly stressed the importance of a coherent and integrated approach between politics, economics and the peace agenda. (For a review of selected sources on postconflict rebuilding from several perspectives, i.e. political, economic, social, security, etc., see Weiss Fagen (1995).)

Rebuilding war-torn societies implies a wide array of complex tasks to be carried out simultaneously against the background of a fragile peace process and political instability. Recent experiences have shown that the line between conflict and peace is no longer clear as violence may erupt from time to time once peace has been formally restored. Many features of economies at war often survive and interact with socioeconomic rebuilding policies. Besides, conflict may still affect parts of a country while peace prevails in others (e.g. Colombia, Sierra Leone, Somalia). For these reasons, the sub-sections on economic policy and peacebuilding include literature on economies at war even if the focus is on postconflict reconstruction.

But before turning to the core issue of economic policy and peacebuilding, this section first analyses the socioeconomic situation that typically characterises a country after protracted conflict. It then dwells briefly on the economic root causes of war that may still prevail once peace is established and which must thus be tackled as a priority to avoid a resurgence of violence.

III.1 Assessing Contemporary Postwar Economies

From existing country case studies, it is obvious that the key issues facing war-torn societies as they start rebuilding their economies vary greatly from case to case. Countries such as Angola, Ethiopia, Mozambique, Nicaragua and the former republics of the USSR have to deal simultaneously with the challenges of a double transition: from centrally-planned to market economy and from war to peace. In these circumstances, privatisation, liberalisation and decentralisation obviously rank among priorities. But other countries emerge from protracted conflicts with an extraordinarily weak public sector. In the Guatemalan case, for instance, one of the most urgent tasks is to restore the legitimacy and capacity of the state to perform basic functions. The peace accords therefore set as a priority the increase of government revenues as a share of GDP from less than 8% to 12% in four years (Minugua: 1996). In other countries where the central state has collapsed, as in Somalia, reconstruction takes place in the absence of national authorities, which is somewhat perplexing for economists accustomed to assessing and designing economic policies with ministries and central banks. Simplistic generalisation is thus inappropriate when describing postconflict situations. Nonetheless, empirical studies on economies at war presented in the former section, as well as on recent experiences in the transition from war to peace reveal that the following often emerge as common features: *fragile peace-consolidation process* and continuing local rivalries between former enemies that breed political instability. In addition, the culture of violence inherited from the war coupled, with abundant availability of weapons, may give rise to widespread criminality; *lack of confidence among socioeconomic actors*. Owners of capital may be reluctant to invest in sectors where it is mostly needed, i.e. in fixed productive assets such as agricultural infrastructure; *weak judicial, financial, fiscal, administrative and regulatory capacities of the state*. This depends on the preconflict situation as well as on how far public institutions have been affected by the war. In Somalia, for example, the government and all public institutions have virtually disappeared over the past seven years. It has however been argued that institutional weakness might in certain cases be accompanied by a plethora of "superfluous" departments, agencies and parastatal organisations created or strengthened during the war to regulate the economy; *large shadow economy (informal sector), parallel markets and/or criminal activities,* implying that considerable segments of the economy lie outside state control and do not appear in statistics. An example is the alliance between traders, arms dealers and some government officials that often develop during conflict. These groups may have a common, vested interest in perpetuating an environment of scarcity - generating quasi-rents - and maintaining the war machinery. They might even be tempted to revive hostilities to the extent they stand to lose from peace; *bad macroeconomic record* as analysed below (section III.3): high inflation, large budget deficit and low tax base, balance-of-payments deficit and relatively heavy debt burden; *widespread unemployment*. Labour supply may sharply increase as ex-combatants are demobilised, and as refugees and internally displaced people return home. The reinsertion of these potentially destabilising groups requires urgent and costly *ad hoc* programmes; Sudden and massive *movements of population*; *dramatic lack of skilled manpower*. Education has been neglected, skills have been diverted by the war or qualified personnel have fled abroad and not been replaced; *damaged/obsolete physical capital and production facilities*, destroyed infrastructure such as power plants, transportation and telecommunication networks, harbours and airports, etc. In some countries, landmines constitute a major impediment to rural development and food production; *low absorption capacity* in the face of pervasive intervention of the international community through a plethora of agencies and organisations involved in humanitarian, economic and political areas.

Some of these characteristics are not dissimilar from those facing other crisis-ridden developing economies. However, postconflict countries often have relatively less capacity to address the crisis which appears in starker relief than in countries at peace, mainly because fiscal and external constraints on macroeconomic equilibrium are exacerbated in wartime. Other characteristics clearly distinguish societies in transition from war to peace from other low-income and middle-income economies. War modifies the behaviour of private agents, both firms and households, due to increased uncertainty and the survival strategies discussed above. In some instances, central government and state institutions have collapsed. Barter trade has been substituted for currency transactions and informal economic activities have overshadowed formal markets. Hence, in certain cases , basic exchange, trade and banking services may have to be rebuilt from scratch (OECD, 1997: 52).

III.2 Tackling the Root Causes of Conflict

A broad consensus prevails among scholars that postconflict reconstruction cannot succeed unless the root causes of war are correctly understood and addressed. Social scientists have stressed that sources of conflict are many and various, and that understanding their subtle interactions requires a broad, multidisciplinary perspective[5]. A single factor can rarely be identified as the sole root cause of conflict. Thus, socioeconomic variables only provide a limited and partial picture of the rationale for war but may still be an important factor contributing to the violent outburst of a conflict. For instance, Stavenhagen (1996) conducted a wide-ranging study on ethnic conflict and the nation-state and concludes that economic factors do play a crucial role in the generation of ethnic conflicts. But these factors must be combined with tribal, religious or ethnic enmities that are often invented by the contending parties to justify or legitimise violence: "When regional and social disparities in the distribution of economic resources also reflect differences between identified ethnic groups, then conflicts over social and economic issues readily turns into ethnic conflict" (p. 294).

There is no consensus yet with regard to the relationship between socioeconomic variables and violent conflict. It has been recognised that the relationship works both ways: political instability may be the result of a disappointing economic performance, and poor economic development may stem from a high degree of insecurity and violence. From the research conducted by various economists and other social scientists (e.g. Van de Goor *et al.*, 1991; Alesina and Perotti, 1993; Nafziger, 1996), it appears that socioeconomic causes of war chiefly derive from the following factors: unequal or negative growth; competition over scarce resources; abrupt shifts in income and wealth; institutional changes resulting from the socioeconomic development process; lack of regional economic integration; competition for access to food, water, capital, health and education services, etc. Such socioeconomic causes contributing to the emergence of violent conflict often survive or reappear once fighting is over. Addressing them is a priority and implies taking into account the complex interactions between the economic, political, cultural and historical factors that are at play.

Even if the root causes of war have been recognised as a priority, economists working in the area of conflict and rebuilding have been primarily concerned with economic policies and structural adjustment as well as with external assistance. The following sub-sections concentrate on the literature related to these central issues.

III.3 Economic Policy and Peacebuilding

Except in cases of overall state collapse, governments are supposed to design and implement social and economic policies, even in the midst of civil war. The absence of policy other than those strictly dictated by war efforts may actually be one policy option that reflects a deliberate attempt to withhold public services and supplies from parts of the country to weaken the rebels. In any case, civil war tends to seriously undermine the capacity of the state to govern, as well as its political autonomy and administrative ability to promote a broadly-based development programme.

Often critically short of expertise in macroeconomic management, domestic authorities have to wrestle with the competing demands of economic stabilisation and peacebuilding requirements. While the former requires drastic cuts in government expenditure, the latter implies increased public spending to cope with the pressing requirements of the peace agenda. Postwar states are in dire need of resources, especially to: (i) rehabilitate the state apparatus, the security system and public services such as education and health; (ii) restore physical infrastructure and productive assets; (iii) reintegrate ex-combatants and returnees; and (iv) clear mines (for more details on the role of the state in rebuilding the economy, see WSP, 1997a). Referring to rebuilding strategies for the Horn of Africa, Brown *et al.* (1992: 195-209) argue that first priority should be given to restoring the state sector's technocratic capacities. The public sector should be supported so as to enhance its capacity to intervene in the provision of services as well as in the strengthening and regulation of markets.

Flawed economic policies have often been followed prior to war and macroeconomic imbalances tend to worsen during conflict. Some authors therefore argue that macroeconomic stability remains one the most important elements of any economic rehabilitation endeavour (e.g. Kumar, 1997: 30). Other analysts contend that political stability should have priority over any other objective, as economic rebuilding efforts would be automatically impaired if war starts anew. It is essential to assess to what extent standard economic recipes should apply to postconflict settings by evaluating how they interact with peacebuilding and reconstruction agendas. There have been remarkably few studies on the linkages between economic policy and peacebuilding as well as on the impact of orthodox adjustment strategies on war-torn countries (see section III.4). Some economists have however assessed the challenges and options facing war-torn countries with regard to distinct economic policies, as reviewed below.

Fiscal and Budgetary Policies

Statistical evidence confirms that during the war, *government revenue* generally falls in absolute terms as the fiscal base narrows and major sources of revenue diminish. But government revenue does not invariably decrease as a proportion of GDP. This proportion even rose in a majority of cases studied by Stewart *et al.* (1997), with the notable exception of countries where government lost its tax collection capacity (e.g. Somalia, Afghanistan, Cambodia). *Government expenditure* on the other hand tends to rise as a proportion of GDP chiefly because of the war effort drain. As a consequence, *budget deficit* increases, as confirmed for all countries for which data is available. This may be aggravated by a collapse of public and private institutions accompanied by the diversion of skilled labour, which is either mobilised for the war or else flees abroad.

As far as the *sectoral allocation of government resources* is concerned, empirical surveys on war economies show that, as expected, the share of military expenditure tends to increase. More surprisingly, data gathered by Stewart *et al.* (1997) reveal that per capita expenditure on health and education was either sustained or rose in several countries where governments could maintain their capacity to deliver basic services (and raise taxes) in spite of the conflict. The share of investment in total public expenditure tends to fall in countries at war, and this to a greater extent than in other developing countries implementing expenditure-cutting measures under stabilisation policies.

A peace settlement reduces military expenditure ("peace dividend"), but increases spending for urgent reconstruction requirements and the restoration of health and education services. There is thus a pressing need to both raise government revenue and contain budget deficit. FitzGerald (1997: 54) argues that as the tax base is limited, governments may increasingly resort to indirect taxation (e.g. taxes on gasoline and/or electricity, import duty on non essential consumer goods) and user fees for public goods and services (e.g. transportation and health services). This option must be assessed on a case-by-case basis as it is often politically costly for the incumbent government, and may also revive inflation. Besides, indirect taxation may lead to a more regressive tax system and widen gaps between the rich and poor[6]. But it sometimes represents the only short-term solution as increasing direct tax collection in the short run might not be realistic in postconflict countries often accustomed to major tax evasion and lacking efficient tax administration. Tax amnesty may help redress this situation together with efforts to strengthen and modernise administrative, auditing, and fiscal control capacities (Segovia, 1996b: 107-127).

Inflation and Monetary Policy

Inflation generally rises as governments resort to deficit financing to pay for war efforts while at the same time striving to maintain some essential services. FitzGerald (1997:48) notes that governments can basically resort to three different sources to pay for the war: (i) foreign aid or lending; (ii) forced credit from domestic banks; and (iii) increased money supply. Resorting to foreign sources may involve a high degree of conditionality and is constrained mainly by aid donors, as borrowing opportunities are very limited for poorer countries. As for the second option, the domestic banking system is often very weak and may be the sole financing source for the requirements of production sectors, especially agriculture. The central bank is thus put under considerable pressure to relax its monetary policy (third option) and inflation can hardly be avoided. In addition, prices may further increase as a result of restricted supply of consumer goods: domestic production and imports fall and informal traders are enticed to sell products at higher prices on parallel markets, taking advantage of quasi-rents generated by supply shortages. The resulting inflation can have highly damaging effects on market entitlements as well as on the well-being or even survival of the poor (Stewart *et al.*, 1997: 28).

In the aftermath of conflict, fiscal deficit is obviously subject to large fluctuation. These shocks must be monetised to a large extent, the government having only limited recourse to debt instruments as potential investors fear that the government might default (Collier and Gunning, 1995: 235-238). As a result, *inflation* tends to fluctuate greatly and prevents the price stabilisation required, not only to protect the poor, but also to restore confidence among economic actors as well as savings and investment incentives. The two authors therefore argue that as far as *monetary policy* is concerned, the government should avoid money targeting as it would fail to keep prices constant because of large and unexpected shocks in money demand.

To the extent that investor confidence returns after the war, demand for domestic money may vary sharply depending upon which liquid assets are being reduced.

Besides, the volatility of inflation leads to switches into and out of domestic currency and adds to the volatility in money demand. Adapting money supply to these changes in demand is impractical. Collier and Gunning (1995) suggest that the government should target the price level within an agreed range and use fiscal rather than monetary policy in response to observed deviations of prices. In practice however, this strategy would require an accurate and readily available consumer price index which is often lacking in postconflict countries.

Foreign Exchange

Recent experiences show that the impact of conflict on the exchange rate varies from case to case. In some countries, barter and/or foreign (hard) currency tend to replace domestic currency when it has lost most, if not all of its value. In parts of Bosnia and Herzegovina, for example, the Deutschmark came to serve as a major form of payment. The situation is further complicated by the *de facto* division of the country into three monetary areas: the Bosnian dinar, FRY dinar and Croatian Kuna areas (World Bank, 1997b). In other instances, large influxes of worker remittances linked with increased money demand by international agencies may counterbalance devaluation and even lead to an appreciation of domestic currency (e.g. El Salvador and, to a lesser extent, Guatemala). Interactive action/research conducted by the War-torn Societies Project (WSP) since 1994 in Eritrea, Guatemala, Mozambique and Somalia reveals that the significance of economic ties with nationals that emigrated abroad tends to be overlooked as there are often no statistics to keep track of these informal flows. Remittances may in fact contribute to a considerable extent to war finance and/or to the survival strategies of the affected population (Angoustures and Pascal, 1996).

Domestic currency may be extremely weak in some postconflict countries, while it remains relatively stable or even appreciates in others. In the case of El Salvador for example, the foreign exchange bonanza accruing from abundant remittances sent from emigrants working in the United States coupled with increased demand for domestic currency by numerous foreign agencies active in reconstruction has contributed to a prolonged overvalued exchange rate. In other countries such as Iraq, the government has maintained a fixed exchange rate for official transactions, while domestic currency depreciated considerably on the parallel foreign exchange market. Such parallel foreign exchange markets are likely to emerge during war and are fed by family remittances from emigrants, export smuggling and leakage from foreign agencies. FitzGerald (1997: 49) argues that parallel foreign exchange markets result not only from misguided policies, but rather from a mismatch between demand for imports and the socially desirable allocation of limited foreign exchange.

As for policy options on foreign exchange after war, undervaluation has the advantage of inducing substitution of nontradable for tradable sectors and contributes to redressing balance-of-payments problems. It further encourages resident and non-resident nationals that hold foreign assets to bring back part of their capital into the country to finance domestic investment. But for Collier and Gunning (1995; 240), undervaluation should clearly be a temporary objective to avoid factor misallocation. These authors suggest that there always exists a premium on "free" market exchange rate and the subsequent elimination of parallel markets. They argue that the long-term exchange rate should render exports profitable while discouraging smuggling and black market.

Savings

As a result of falling income during the conflict, domestic *savings* are likely to decrease in absolute terms. The cross-country survey mentioned above indicates that gross domestic savings ratio also falls, in most cases. This decline may result from the necessity to maintain consumption levels in spite of reduced incomes. This trend may be balanced by a shortage of consumption goods leading to *de facto* forced savings, or else inflation in consumer good prices. FitzGerald (1997: 52) notes that the evolution of the ratio of savings to GDP may be ambiguous: uncertainty about life-span might reduce incentive to save for higher immediate consumption, but on the other hand higher uncertainty linked with war conditions may increase precautionary savings.

Gupta (1990: 180-182) remarks that a reduction in savings will generally not result in an increase of consumption that would allow for an upward multiplier to take the economy to a higher level of prosperity under normal conditions. For uncertainty linked with political instability impairs many of the automatic, self-correcting and equilibrating market mechanisms. General lack of faith in economic prospects and institutions may lead to substantial "hoarding": individuals can either "store their money under the proverbial mattress (thereby withdraw money from the natural flow of economic activity), or they can send their money illegally (as few countries allow a free remittance of money abroad) to a safer haven, such as a Swiss bank, or to a politically stable nation." (Gupta: 1990: 181). Another option is to buy precious metals such as gold or silver. Consumption and savings tend then to decrease while the price of precious metals might increase. In a theoretical attempt to introduce exogenously determined political instability in a general equilibrium framework, Gupta (1990: 186-190) then assesses the impact of uncertainty on a typical Keynesian macroeconomic system (commodity, money and labour markets). The resulting multiplier also reveals a strong negative impact of political instability on the economy.

Investment

Conventional wisdom would indicate that *private investment* falls as conflict breeds distrust and uncertainty. The ensuing higher risk and greater transaction costs discourage foreign and domestic investors. Political instability is likely to further cause an increase in *interest rate* which in turn reduces investment incentives. This upward trend in interest rate is due to the fact that hoarding lowers the amount of money available for lending. In addition, the higher level of uncertainty itself raises interest rates. FitzGerald (1997: 50-51) adds that contrary to natural disaster, war not only damages the existing capital stock of firms, but also reduces desired stock level or investment plans. For expectations regarding profitability, domestic demand and export opportunities worsen as a result of prohibitive risks. The cross-country survey by Stewart *et al.* (1997: 25) clearly confirms that the absolute level of investment falls significantly in most cases. However, the negative impact of war on the ratio of investment to GDP appears less severe.

These economists further analyse how conflict affects the *allocation of* public and private *resources among production sectors.* During hostilities, the sectoral allocation of funds changes under the combined impact of increased transaction costs, market disruption, and the macro effects mentioned above, leading to considerable variations in sectoral outputs. Foreign and domestic private firms are unlikely to increase their productive capacity because of the inordinate risks, whereas state-owned enterprises may replace losses or increase capacity as long as there is political will and financial resources behind it. *Large firms* may be in a position to organise some form of security, e.g. hiring the services of the army or of private security forces, but they tend to be more affected by workforce instability and damages to infrastructure. Small producers are more adaptable and can easily move into or resort to informal networks. Some "investors" are likely to compete harshly to make profits out of the exceptional opportunities that arise during wartime from the disintegration of competitive markets and fragmentation of the economy, especially illegal trading activities.

Because of the climate of instability, private agents may resort to other *investment choices* than fixed capital formation. In a study focusing on African civil wars, Collier and Gunning (1995: 233-237) underline that uncertainty leads to a portfolio shift from fixed to financial or liquid assets as real fixed assets become vulnerable to war damage. Some groups are thus likely to accumulate unusually high savings. As for portfolio decisions, there is a high premium on liquidity during the war. The safest financial asset with the highest return probably is a foreign interest-bearing claim (e.g. bond or bank deposit), but access to transactions may be inconvenient as deposits and withdrawals must be conducted externally. This is not the case of transactions in foreign and domestic currency or with domestic interest-bearing assets. Available evidence for some African war-torn countries (e.g. Ethiopia, Mozambique, Uganda) indicates that portfolio choices of private agents result in an increase in liquidity in a range of foreign and domestic financial assets, depending on the penalty for holding domestic financial assets (i.e. inflation level, currency stability, availability of reliable financial services, etc.) as well as on the difficulty of conducting financial transactions abroad.

Gupta (1990: 194) remarks that, provided business and consumer confidence returns after hostilities, the saving and hoarding accumulated during the conflict may find their way back into the nation's income stream, as experienced by the Western World after World War II (analogous to the *real balance* or *Pigou* effect). But in the case of contemporary postconflict countries, macro-level instability added to the high level of criminality and political insecurity often discourages the acquisition of visible assets and perpetuates the premium on liquidity that emerged during the war. Potential *investors* tend to keep their assets in liquid forms despite the transition from war to peace. They usually adopt a wait-and-see attitude before switching from liquidity to domestic fixed investment (Collier and Gunning, 1995: 236), or they may be more tempted to acquire the consumption goods that they could not buy during the conflict (FitzGerald, 1997). Alternatively, they may prefer to invest abroad or to keep foreign currency denominated financial assets, often in cash. Thus, private investment may not increase sufficiently to restore growth and employment due to uncertainty about future profits as well as about asset and land ownership, as discussed below.

To the extent that private agents do nonetheless switch from liquid to fixed assets, there are strong incentives to invest in quick-yielding, mobile assets such as transport equipment and light machinery as such investments can be easily redeployed elsewhere in case of renewed crisis. Consequently, economic agents are reluctant to invest money where it would be most needed, i.e. in fixed, productive assets such as agricultural infrastructure. The reluctance of investors to do so at the end of a protracted conflict is primarily responsible for the lack of supply response that orthodox economic reforms are expected to spur. Crosby (1990: 22) therefore argues that a top and urgent priority is to restore local investor confidence, which requires that a whole range of conditions be quickly met. Among them, Crosby mentions political and macroeconomic stability, the restoration of the rule of law, access to credit at reasonable rates, low or predictable levels of inflation, a convertible currency, a clear regulatory framework, and access to market information and efficient trade-related services.

Trade Policy and Regional Economic Integration

Empirical surveys reveal that war conditions lead to a fall in *exports* as trade routes may be disrupted, and transportation means and infrastructure destroyed. As a result of decreasing export earning, the *import* capacity falls unless net external finance increases to a greater extent than the fall in exports, which is most unlikely in the case of low-income countries at war. In a vicious circle, the drop in imported production inputs in turn reduces export capacity.

Official trade flows are also affected by the fact that conflict disrupts traditional migratory and trading routes. On the other hand, unofficial cross-border trade tends to develop and sometimes becomes the main form of interregional trade activities in the aftermath of a conflict, as shown by McSpadden (1996) in the case of the Horn of Africa. Illegal trade tends to flourish as a combined consequence of increasing arms and drug trade and tight border controls or embargoes (e.g. Labrousse, 1996: 467-494_ Kopp, 1996: 425-465). Once the conflict is over, illegal traders are likely to resist any attempt to reintegrate into the formal sector as they attempt to maintain their profits. In addition, widespread customs corruption and excessive administrative burden discourage formal trade. Customs administration thus deserves particular attention if trade is to serve as a catalyst for growth, (WSP, 1997a: 8).

As for postconflict trade policy, conventional reform relies on trade liberalisation measures involving the reduction or removal of tariff and non-tariff barriers and other anti-export bias[7]. These measures may have major impact on income distribution between social groups and production sectors, and in a fragile peace process, this cannot be relegated to second-order priority[8]. Under normal circumstances, distributional effects tend to be felt immediately whereas expected gains in competitiveness, in output, and in exports might be delayed for a minimum of a year or two. But in the aftermath of a conflict, these benefits may be frustrated by the lack of supply response and market imperfections characterising war-torn economies.

In a study on trade policy and domestic political alignments based on the standard Stolper-Samuelson theorem, Rogowski (1989: 19-20) concludes that changes in exposure to trade profoundly affect internal political cleavages between capital, labour and land interests. He adds that appropriate and temporary compensations may help avoid a resurgence of violence. However, postconflict countries often lack the financial capacity to provide assistance to "losers" from trade reforms. The microeconomic impact of trade liberalisation should thus be carefully assessed in the context of war-to-peace transition.

Contemporary countries at war and postconflict economies often have stronger commercial ties with partners overseas - mainly industrial countries - than with their own neighbours. These war-torn countries often offer - and/or enjoy - better market access conditions vis-à-vis remote trade partners, contrary to the prevailing trend toward deeper economic integration at regional rather than multilateral levels. This limited *regional economic integration* can further exacerbate competition over resources and may negatively affect the peace and reconciliation process. Nafziger (1996: 8) states that "lack of regional economic integration not only increases the transaction costs of inter-regional trade flows, investment, and migrants, but also reduces the extent to which major social forces in the regions have a vested interest in remaining politically integrated with other regions". He further illustrates with examples like former Zaire, Nigeria, and Pakistan before partition that political cohesion is partly a function of the extent of economic integration. A recent analysis carried out by the Swiss Trade Initiative Middle East North Africa (STIMENA) points to the fact that mutual trade within this region is very low compared to trade with key third parties: in 1995, mutual trade between Egypt, Israel, and Jordan accounted only for 0.5%, 3.6% and 1.1% of their total respective trade, compared to 58.5%, 65% and 32.4% with the European Union and the United States of America (STIMENA, 1997: 7-8).

Regional integration mechanisms are slowly but surely taking the place of political crisis-solving functions (Haluani, 1996). Crosby (1990: 133) notes for example that the Arias Peace Plan has encouraged Central American countries to deepen regional economic co-operation and reinvigorate the Central American Common Market (CACM), as regional integration offers a chance for regional stabilisation and economic development. Ayalew (1992: 94-103) states that increased trading activities among neighbouring countries in the Horn of Africa would help bring about political stability in the region as common interest may then dominate current differences. Existing regional groupings like the Preferential Trade Area for Eastern and Southern African States (PTA) and the Inter-governmental Authority on Draught and Development (IGADD) could be instrumental in strengthening regional integration in the Horn of Africa.

Agriculture

Researchers and agencies involved in reconstruction tend to agree that the restoration of agriculture production should be treated as a priority since increased food production reduces the dependency on foreign aid that developed during the conflict and helps restore market entitlements. In addition, agriculture often represents the dominant export activity and is a major source of foreign exchange and government revenue. Agricultural development can further facilitate the reintegration of ex-combatants and civil returnees in rural areas (WSP, 1997a: 8).

FitzGerald (1997: 50-52) remarks that rural areas are more vulnerable to conflict as peasants may be forced off their land and assets are easily stolen or destroyed. Besides, the agricultural export sector suffers disproportionately from war damages as government tends to overtax it and rural transportation becomes vulnerable (Collier and Gunning, 1995: 239). This may be aggravated by the disruption of commercial circuits, frequent looting and many landmines in rural areas. Furthermore, private investment in agricultural production remains low, as it is often perceived as being too risky in postconflict settings. Statistical surveys confirm that domestic food production per capita tends to fall; in relative terms however, this needs to be qualified. Edmonds (1988: 95-101) notes in the case of Uganda that subsistence agriculture grew sharply in relative terms during the war whilst the importance of monetised agriculture, industry and services declined. Similarly, data reviewed by Stewart *et al.* (1997: 29) confirms an increase in the share of less transaction-intensive activities, concentrated mainly in agriculture and services[9]. This trend may appear even greater if the massive shift to informal and subsistence sectors is taken into account (e.g. petty trading, staple food production). Under normal circumstances, the agricultural sector is meant to benefit from conventional economic reforms aimed at removing anti-agricultural bias and promoting non-traditional agricultural exports. But FitzGerald (1997: 60) underlines that in the case of war-torn countries, farm price deregulation does not necessarily increase peasant output unless (i) credit and transport conditions are improved; (ii) the question of land ownership is appropriately settled; and (iii) farmers can spend their harvest earnings on producer goods such as fertilisers or agricultural machinery. He adds that this exchange relationship between rural peasantry supplying food to urban centres and buying producer and consumer goods from them largely determines the real living standard of the poor and should thus be restored as a priority.

The state may have an essential role in providing the right incentives as public investment in the agricultural sector can help attract private investors (crowding-in effect). Collier and Gunning (1995: 239) suggest that a possible strategy for the government is to make the necessary investment in non-tradable capital and lease it to private entrepreneurs on short, but renewable tenure, or else to subsidise the act of commitment of private investors in irreversible agricultural assets. But while the former option makes private agents vulnerable to the government that becomes landlord, the latter might lead to corruption rather than judiciously "backing winners" through subsidies.

Before concluding this sub-section on agriculture, it is necessary to mention the issue of land ownership and land reform. Researchers have highlighted the link between land concentration, income distribution and conflict as land reform often has a bad record in economies at war. The struggle over land and resources, which means a struggle over power, is at the bottom of violence in countries such as Guatemala (Stavenhagen, 1996: 126-129) where 2% of the population hold more than 60% of the land while almost 90% of the farmers hold less than 20%. High concentration in land ownership and failed land reform implies greater inequality in income distribution and increased poverty, and can easily spur renewed political violence (Weede, 1992: 262-284). Nafziger (1996: 4-10) adds that rapid population growth together with severe environmental degradation constitutes another factor of conflict. In this context, access to arable land is of particular relevance (including land tenure and access to water for drinking and irrigation)[10].

III.4 The Structural Adjustment Debate

Since their inception, structural adjustment programmes have given rise to discussion and controversies among economists and other social scientists. As the vast majority of postconflict countries are low-income or low-middle-income countries in urgent need of external financial support, this debate lies at the heart of recent literature on socioeconomic rebuilding. Controversies on structural adjustment are particularly acute in the case of war-torn countries. Many analysts have argued that the necessity to redress macroeconomic imbalances often contradicts peacebuilding and reconstruction priorities, and can thus impair reconciliation efforts. This section focuses on the heated discussions on the interactions between peacebuilding and orthodox economic reforms.

Economic adjustment involves both stabilisation and structural adjustment. *Short-term stabilisation* policies as designed primarily by the International Monetary Fund (IMF) traditionally aim to reduce inflation, restore currency convertibility and renew debt service. They involve expenditure-cutting measures as well as sharp tightening of fiscal, credit, and monetary policies. *Structural adjustment* lies rather in the realm of the World Bank and the regional development banks. It involves economic liberalisation through the removal of controls and regulations, privatisation, and the implementation of export-oriented policies.

The international financial institutions are often the main creditors of countries at war as well as of postconflict economies. They play a crucial role in the design of economic policy as they determine which economic reforms are required to allow a country access to foreign funds. Following a major study on economic policy and peacebuilding in El Salvador, Boyce and Pastor (1997: 287-294) argue that economists and the international financial institutions they staff are not equipped to operate in postconflict situations. They tend to take for granted the basic underpinnings of the economy, with a well-established legal system to enforce property and contracts and well-defined social norms. But these have often been shattered by civil war, if indeed they ever existed. Boyce and Pastor stress that macroeconomic stability and fiscal discipline are required even as countries seek to finance the requirements of peace. However, they add that the objectives of economic policy in postconflict situations cannot be limited to conventional economic and structural adjustment. Economic policy should also promote adjustment toward peace, for there is no prospect for sustainable development as long as minimal stability and predictability have not been restored.

FitzGerald (1997: 57-58) recognises that sound macroeconomic policies, fiscal solvency, price stability and a manageable balance of payments are highly desirable objectives. But he adds that orthodox economic adjustment packages may have counterproductive effects in the context of war-torn societies and may produce results quite contrary to policymakers' expectations. In theory, adjustment policies imply that supply and demand are highly responsive to changes in relative price. But, as argued above, this is often not the case in postconflict economies mainly because private investors are reluctant to commit their assets to the type of fixed, long-term investments that are needed to restore growth and employment. A series of examples are given to illustrate the potential outcome of specific measures in postconflict situations:

Devaluation of the nominal exchange rate may be passed entirely to domestic prices as imports are largely debt financed or administratively allocated (very low price elasticity of import demand). Export volume may not increase at all as supply is limited by lack of investment. *Import liberalisation* may simply hit competing domestic enterprises and encourage import of non-essential goods and services. The *reduction of fiscal deficit* can be instrumental in reducing inflation, but increased real interest rates harm production and may not result in an increase in bank deposits as confidence in the exchange rate and the domestic financial system is low in the aftermath of conflict. Edmonds (1988: 109) argues that strict and indiscriminate credit ceilings undermined stabilisation efforts in Uganda during the first half of the 1980s. In addition, cuts in public expenditure negatively affect government investment capacity and the real wages of civil servants. As for tightening of monetary policy, Hanlon (1996) recognises that there may be a surplus of money in the direct aftermath of a war because governments tend to print money to pay for the war. But he argues that productive capacity is also artificially depressed because of war damage and thus calls for the restoration of production *simultaneously with* the reduction of money supply (stabilisation *and* growth) instead of the stabilisation *before* growth sequence imposed by the IMF.

Agricultural revival has been pointed out as a key factor in successful postconflict reconstruction. The expected benefit of *farm price deregulation* can however be cancelled out by credit constraints, infrastructure and commercialisation bottlenecks, and the lack of input supplies that prevent farmers from increasing production. This has been confirmed by recent research on the impact of structural adjustment on agriculture in Mozambique (WSP, 1996 and 1997b). Interactive research undertaken by the War-torn Societies Project highlights the necessity to restore basic agricultural extension services, transportation and irrigation systems and the storage facilities that have been destroyed during the war (WSP, 1997a). This would require that peasants and merchants enjoy favourable conditions of access to credit, but financial services are rather rudimentary and credit policy implemented under stabilisation programmes is restrictive, not to mention bureaucratic barriers (Hanlon: 1996).

Referring primarily to African and Central American countries, several authors criticise structural adjustment policies for eroding public institutions and weakening the state's capacity to mediate conflict, secure law and order, and rebuild essential infrastructure and services. They argue that structural adjustment tends to widen inequalities during conflict, and thus aggravate political tensions (e.g. Crosby, 1990; Hanlon, 1996; Prendergast, 1996a and b). Brown *et al.* (1992: 197) further remark that "the desperation of most African governments for foreign exchange has tended towards "monologue" rather than "dialogue", enabling donors to exercise considerable leverage in economic policy formation and implementation". It has been widely argued that governmental commitment to reforms is paramount for the success of economic adjustment. Thus, the executive authority should not be simply forced to implement reforms, but rather be firmly convinced of the necessity of economic stabilisation and liberalisation (Sandbrook, 1996: 5).

Looking at the elimination of potential causes of conflict, Nafziger (1996: 4-10) warns against large and abrupt shifts in income and wealth distribution resulting from the development process itself, and from structural adjustment in particular. He underlines that adjustment programmes redistribute the timing and extent of costs and benefits of reforms among economic actors. Most expenditure-reducing policies and some expenditure-switching policies tend to impose immediate welfare costs, while benefits emerge only after a period of at least one or two years during which the perceived grievances of classes and regions mount with regard to adjustment. This may readily rekindle tensions and jeopardise a fragile peace.

III.5 Foreign Aid and External Intervention

In the case of low-income countries at war, external finance is often limited to balance-of-payments support, humanitarian assistance provided by foreign aid agencies and financial aid by international institutions. When there are limited domestic financial and human capacities, foreign assistance obviously plays a crucial role in helping war-torn countries in political, social, and economic rehabilitation. Foreign aid is particularly important in the first phase of reconstruction to assist in the rehabilitation of vital social services and productive infrastructure as well as to finance reintegration programmes for ex-combatants and civil returnees (Colletta *et al.*, 1996a and b; Collier, 1994). The removal of mines and unexploded ordnance is also an urgent but extremely expensive task, especially in heavily "contaminated" countries such as Cambodia, Mozambique and Bosnia-Herzegovina (Davies, 1996: 241-263), the cost of removing one mine being estimated between US $300 and $1,000.

In their 1997 Guidelines on Peace, Conflict and Development Co-operation, OECD/DAC Members set the following priorities for postconflict reconstruction (OECD, 1997: 50): "Restoring internal security and the rule of law, legitimising state institutions, establishing the basis for broadly-based economic growth, and improving food security and social services. This may require reforming security forces and legal systems or helping establish completely new structures where the former are viewed as illegitimate by society." As for the World Bank, postconflict reconstruction aims to facilitate the transition from war to a sustainable peace, and to support economic and social development. This requires that "a peacetime economy be rebuilt as soon as possible, and that state-society relations are restored at all levels... . Assistance must focus on re-creating the conditions that will allow the private sector and institutions of civil society to resume commercial and productive activities." To this end, support may be required for macroeconomic stabilisation, for rebuilding financial institutions and legal frameworks, as well as for rebuilding transportation and communication infrastructure (World Bank, 1997a: 9-11). The World Bank further recognises that "participatory approaches and community-based schemes, especially under the unique conditions of postconflict reconstruction, have a particularly valuable role in helping to restore local capacity."

External assistance is neither neutral nor risk free. Through massive intervention, foreign agencies come to exert considerable influence on the way postconflict economies evolve. Subject of many debates and controversies, aid is a powerful instrument for policy conditionality and is often used as a lever for economic reforms and/or for peacebuilding requirements, as will be discussed under section V below. Traditional macroeconomic concerns posed by foreign aid in normal times may appear in starker relief under postconflict conditions. The main difficulty is to strike a balance between urgent needs and high expectations at the end of hostilities and the negative side-effects of aid. With a view to avoiding potential pitfalls, recent research concentrates on the negative effects that external assistance may have on conflict-ridden countries. Several studies warn that externally funded aid extended with pure humanitarian motivations may in fact revive conflict. Anderson (1996) shows that aid more often worsens conflict rather than helps mitigate it. Analysts such as Jean and Rufin highlight that, during the conflict as well as in its immediate aftermath, foreign aid may contribute to sustaining the war or exacerbating its causes by increasing resources available to continue the conflict. Prendergast (1996b: 17-36) illustrates how aid can be used directly as an instrument of war by one or more parties to the conflict by manipulating access of foreign agencies to victims or using civilians as shields or food sources for combatants. Armed factions may also divert or simply steal humanitarian inputs for their own consumption, or for barter, sale, or even export.

In the aftermath of a prolonged war, external resources may serve to ease both the severe fiscal and foreign exchange constraints, but it may also aggravate fierce competition in an environment of acute scarcity. Aid therefore often heightens tensions. This is especially true when some groups feel that they are discriminated against by unfair aid provisioning as the modalities of external assistance distribution further affect the structure and balance of power within recipient communities as well as between warring parties. It has been pointed out that assistance should not be limited to the most vulnerable people, but extended to the whole community in order to avoid discrimination and subsequent resentment (Kumar, 1997: 21-22). Turning to the impact of relief on the economy, analysis in recent literature has centred on the following issues:

· External assistance might be urgently needed to restore basic food entitlements, but it is now well established that food aid exerts a downward pressure on internal prices and thus reduces food producer and self-reliance incentives.

· Massive foreign intervention contributes to major sectoral price increases, chiefly accommodation, urban land and skilled labour, as exemplified by Cambodia with UNTAC (Utting, 1996). The sudden influx of international agencies, foreign personnel and external aid leads to a skewed growth process whereby resources and skills are suddenly diverted away from key sectors and activities - mainly agriculture, manufacture and public services - while the urban-based service sector flourishes.

· Foreign grants and soft lending conditions may ease credit constraints, but they tend to crowd out local financial intermediaries that could potentially channel domestic savings, especially to rural areas (Segovia, 1996a: 111-112).

· The exchange rate tends to appreciate because of massive aid flows and increased demand for local currency (Dutch disease). The ensuing overvalued exchange rate is detrimental to both export and growth, as illustrated by the Salvadoran case (Boyce, 1996).

· Counterpart funds of import support schemes accruing from the sale of aid-funded commodities on domestic markets may be deflationary or may help contain inflation, but only to the extent that governments use these funds to reduce the fiscal deficit rather than to raise public expenditures (FitzGerald, 1997: 56).

At a more operational level, emergency relief, rehabilitation work and development programmes all co-exist and interact in several ways during the transition from war to peace. Since the end of the Cold War, the international community has established a whole range of principles, guidelines and best practices in order to overcome potential contradictions and to integrate external assistance within the framework of a coherent, integrated, and long-term strategy. Although tribute is paid to these recommendations in official statements, observers in war-torn countries remark that so far they have seldom been put into practice.

These recommendations mainly warn against the risk of foreign aid crowding out local initiatives and institutions, taking over basic functions of weakened states and reinforcing aid dependency. For, in the medium run, foreign assistance can undermine or even replace local authorities in the provision of minimal welfare services, thus releasing the government from its social duties and freeing resources for military activities (e.g. Anderson, 1996). The labour market may also be negatively affected by the international community: the ever increasing number of foreign agencies and INGOs divert scarce domestic skills from the public and private sectors to their own activities and tend to increase the cost of labour.

Effective economic normalcy will not return before some degree of political normalcy has been restored. As long as this is not the case, large inflows of foreign money increase dependence on external assistance and may turn a postconflict economy into what Gupta (1990) calls a "welfare junky". Large and sudden inflows of foreign aid can temporarily mask the debilitating, negative impact of budget deficit and lack of savings, but do not necessarily entail higher investment in the medium or long run.

In an innovative response to a widely recognised need for systematic analysis of current experience and practice, the War-torn Societies Project was jointly initiated in 1994 by the United Nations Research Institute for Social Development (UNRISD) and the Programme for Strategic and International Security Studies (PSIS) in Geneva. Through interactive action/research in several countries that have just emerged from protracted conflicts, this Project contributes to better integrating different forms of international assistance - humanitarian, economic, political and military - within a coherent framework. More important for the process of reconciliation, it has improved - or contributed to establishing for the first time - policy dialogue on key rebuilding issues among domestic players at the local and national levels, as well as between them and external actors.

III.6 Brief Assessment of the Literature on Postconflict Rebuilding

The interactions between economic policy and peacebuilding are complex and multifarious and economists have devoted much attention to the structural adjustment debate. But one may well ask whether traditional controversies over economic reforms really deserve first priority in the case of certain postconflict countries; in other words, whether other more fundamental variables have not been overlooked so far. Several issues that go beyond traditional debates on macroeconomic management may in fact rank first among rebuilding priorities. The following questions are provided as examples:

In postconflict settings, survival strategies, production for own consumption and petty informal activities may sometimes account for more than 80% of the economy. How should then reconstruction strategies build on this fundamental factor? In the aftermath of protracted war, irrational and emotional behaviour often prevail over economic rationality. How can such behaviour be accurately assessed and accounted for in economic policy making? Dispute and uncertainty over land ownership and land tenure conditions often undermine rehabilitation efforts in the agricultural sector (see also sub-section IV.2 below). In cases where several groups of people have successively lived on - and worked - the same piece of land during the conflict, should controversy over land ownership not be settled as a first and foremost priority? And where mines still infest arable land, how can agricultural production recover? How to absorb rapid and large-scale inflows of population in a given region in terms of food (available reserves, production surpluses and external relief), shelter, labour opportunities, etc.?

Surprisingly, the effects on the economy of massive, forced displacement of population during the war and in its immediate aftermath have scarcely been studied at a theoretical level so far. The socioeconomic challenges involved in the reintegration of refugees and ex-combatants or from vast shifts of population have of course been analysed at an operational (country) level by agencies like UNHCR, ILO[11] and the World Bank[12]. Large and abrupt movements of people exert considerable effects on consumption, production, labour, trade, informal markets, etc. Hence, they cannot be overlooked and should be included in the design of rebuilding strategies.

5 See for instance Van de Goor *et al.* (1996: 1-28) who assess different root causes of war such as historical circumstances, nationalism and ethnicity, religion, state formation and state collapse, competition over resources, democratisation, institutional weakness, and armament.

6 As a result of such concern about distribution, the Guatemalan Peace Accord (Minugua, 1996) requires that the tax system be "globally progressive", in addition to a 50% increase of the fiscal revenue/GDP coefficient.

7 Commercial policy includes the set of measures that have direct implications for the domestic prices of importables and exportables. Border opening benefits export-oriented interests and harms import competing ones, while devaluation of the exchange rate affects the relative prices of tradables versus non-tradables. The global effect on real wages depends on the combined share of tradables/non-tradables and exportables/importables in the income and consumption pattern of a given household (Rodrik, 1992: 23-24).

8 Economic theory predicts that first-order effects affect primary or functional income distribution through changes in output levels, in relative prices of tradable versus non-tradable and exportables versus importables, through job losses in previously protected sectors and job creation in emerging export sectors, etc. These changes in turn affect personal or household welfare depending upon how incomes are distributed by market institutions.

9 The proportion of *industrial production* in total output tends to fall as transaction-intensive activities and long-distance trading are negatively affected by the conflict through massive increase in transaction costs, breakdown in trust among economic agents, and foreign exchange shortage.

10 Population growth, insecure land tenure and environmental degradation can lead to conflict by increasing the need to share scarce resources. The literature on conflict and environment is rapidly expanding, but the theme lies outside the purview of this paper and is not reviewed here.

11 See in particular ILO publications under the Action Programme on Skills and Entrepreneurship - Training for Countries Emerging from Armed Conflict. This is a multidisciplinary and interdepartmental programme that aims to strengthen training and employment-related initiatives and institutions in postconflict countries.

12 For a general overview of recent experiences with the reintegration of ex-combatants, see Colletta *et al.* (1996a and b).

IV. A Wider Perspective on Economic Rebuilding

From a preliminary assessment of the literature above, it appears necessary to widen the scope of socioeconomic research on countries at war and postconflict situation in view of the primacy of political stability in rebuilding strategies. This section therefore briefly reviews relevant literature on the complex nexus of interactions between economic development, distribution and equity, institutions, peacebuilding, and political stability. It first draws on the political economy of reconstruction and distributional issues, and then briefly considers the institutional challenges arising in economic development and postconflict rebuilding processes.

As for the relationship between political variables and economic development in general, Brunetti (1997) provides a systematic overview of the literature on political variables used in cross-country growth analysis. He reviews empirical links between economic growth and five categories of relevant political variables, namely democracy, government stability, political violence, policy volatility, and subjective perception of politics. Two major methodological problems related to cross-section regression surveys are highlighted. First, there is a problem of "simultaneity" as the usual ordinary least square (OLS) regressions used in most empirical studies do not reveal the direction of causation. Authors generally assume that the political process determines the growth rate, but some theoretical arguments indicate that the direction of causation could be the other way round. The second problem relates to the robustness of the econometric results to variations in the specification of the growth equation. Brunetti concludes that measures of democracy are least successful as explanatory variables in cross-country growth regressions, whereas measures of policy volatility and subjective perception of politics are most successful. It is worth noting that the last criteria does not rely on objective measures of political stability, but tries to grasp the subjective perception of the agents that make the growth-relevant decisions. This kind of "subjective" or "psychological" variables seem to exert a significant impact on economic growth, but have just begun to be taken into account in cross-country studies.

IV.1 Inequality and the Political Economy of Reconstruction

Traditional economic theory assumes that private "egoistic" entrepreneurs are driven by profit, while "benevolent" policy makers are seeking maximum public welfare. The "political economy" approach departs from this basic assumption and analyses the demand and supply sides of economic policy, i.e. how individual preferences are defined, aggregated and channelled into political demands and how policy-maker preferences take shape accordingly. Political economy analysis thus adds an essential dimension to research on postconflict rebuilding by placing postwar economic reforms in their political contexts. Under this approach, economic policy is viewed as the outcome of interactions among politicians, bureaucrats and interest groups within a set of institutional constraints.

Shifts in entitlements and inequality may exert a decisive influence on the consolidation of peace. Structural adjustment may have major destabilising effects as living conditions of the poor and politically vocal groups rapidly deteriorate, and longer-term costs and benefits of reforms are redistributed among different economic sectors and classes (see section III.3 and III.4 above). Thus, reforms should not be considered only in their narrow economic aspects, but must be analysed from a political-economy point of view (Boyce and Pastor, 1997: 288-302). Participation of domestic constituencies in policy dialogue has further been singled out as essential to the success of peacebuilding and reconciliation processes (OECD, 1997). This directly relates to the debate on the merits and disadvantages of technocratic insulation for optimal economic policy design and implementation. While technocratic insulation has been praised in the case of East-Asian economic "miracles" (e.g. World Bank, 1993), Boyce and Pastor (1997) argue that it may revive tensions and be counterproductive in the case of war-torn countries. For it contradicts the main objectives of the transition from war to sustainable peace, i.e. (i) the establishment of institutional mechanisms to settle disputes; (ii) the creation of checks and balances on the exercise of power; and (iii) the promotion of a culture of dialogue between former warring parties.

Research on the political economy of reconstruction reveals that the will and capacity of government to implement and manage economic reforms may be a requirement for success, but does not suffice after a conflict. For powerful domestic actors are often in a position to block reforms if they refuse to co-operate (see for instance Putnam, 1988). The political economy approach suggests that domestic constituencies must first be able to recognise their own interests and organise collectively to participate in the policy formulation debate, exert pressure for reforms and improve their situation. Harvey and Robinson (1995: 39-43) remark that interest groups able to influence macroeconomic policy are rather weak in Africa (e.g. Mozambique, Uganda), particularly in the sectors of agriculture and informal activities. Experience shows that opposition to standard economic reforms is more likely to originate in the public sector.

Some authors have remarked that in the direct aftermath of conflicts, governments are sometimes in a better position to implement unpopular reforms as they enjoy wide popular support and credit for the successful settlement of peace. Frey and Eichenberger (1992: 51-67) add that war or natural disaster allows the government to point at these exogenous shocks as the cause for economic deterioration, thus avoiding blame from the population for the negative impact of reforms. The two authors nonetheless conclude that stabilisation programmes are relatively ineffective in countries affected by a conflict: if the recession is not attributed to the government, the latter can use credits granted by international financial institutions for its own purpose (e.g. personal enrichment or suppression of opposition) rather than to improve overall economic conditions.

In a major survey of the literature on endogenous growth and endogenous policy, Persson and Tabellini (1994: 243-262) show that unequal income and asset distribution fuels inequality *via* the whole process leading to economic policy design and implementation. To illustrate this, they provide empirical evidence that high concentration of land ownership tends to be associated with higher sectoral tax rates on the capital intensive sector, and thus lower growth rate. This conclusion is based on the following assumption: the small group of individuals (land owners in the above example) that disproportionately benefits from a policy that is unfavourable in terms of aggregate outputs (higher taxes on capital intensive sectors) is likely to be more organised and more successful in lobbying than the rest of the population. This phenomenon has been discussed in the case of several postwar countries in Latin

America (e.g. El Salvador, Guatemala) and should not be overlooked in the design of postconflict economic reforms.

Now, how do these findings in the field of political economy relate to the peacebuilding and reconstruction processes? The most significant conclusion emerging from extensive research on *income concentration and violence* is the following: poverty and high inequality may often constitute necessary preconditions for the (re)emergence of conflict, but are generally not sufficient to translate into political violence unless combined with some form of group identity that can be mobilised for collective action[13]. Assumptions behind the potential impact of economic factors like poverty and extreme inequality derive from *psychological theories on collective violence*. The relative deprivation theory (Gurr, 1970: 22-30) contends that invidious discrepancies in economic, social, and political values are the most important determinant of conflict. Large gaps between people's socioeconomic expectation and what they actually receive, and the perceived grievance or frustration resulting from such discrepancy, is a major cause for political mobilisation and conflict[14]. Gupta (1990: 51-60) argues that it is necessary to complement the relative deprivation theory by adding the dimension of an individual's *collective* goals.

This theory has particular implications for postconflict rebuilding. For as depicted earlier, internal conflict offers huge profit opportunities to a small minority while living conditions dramatically deteriorate for the vast majority. War therefore tends to increase income concentration and to widen the gap between rich and poor. Much is then at stake during the reconstruction phase:

If aspirations and rising expectations are well in excess of achievements, the resulting frustration is a potentially strong destabilising factor (Adelman and Robinson, 1989: 950-960). Losers have high expectations of rapid improvements once the peace is settled. If these expectations do not materialise, frustration breeds discontent and rekindles tensions.

Winners (e.g. illegal traders, some government officials, operators on parallel markets) have benefited from quasi-rents generated by chronic macroeconomic disequilibria and supply shortages. These new economic elites emerging during the conflict are likely to exert a major influence on the postwar economy, but tend at the same time to perpetuate illegal activities and continue their racketeer behaviour. A basic question is whether it is sound to allow this type of investor to play such a dominant role in the postconflict economy, although this issue has hardly been raised so far. Liberalisation measures tend to eliminate the rents from which powerful groups benefited during the war and who are thus likely to oppose such reforms and resist attempts to integrate into the formal economy. Other people such as elements of the old central army, war-lords, demobilised soldiers, and politically disenfranchised forces are potentially destabilising groups in the postconflict period. They are likely to resort to violence if they fear they may "lose" from the peace deal, all the more in that they often have access to - or still possess - arms and ammunitions (Adekanye, 1997; Boyce, 1996). Adekanye (1997: 364) further warns against the destabilising effects of further impoverishment of vulnerable social groups by structural adjustment programmes implemented simultaneously with postwar reconstruction.

It appears that unequal growth tends to aggravate social tensions even under conditions of positive growth and expanding resource availability once the conflict is over and especially when coupled with growing regional and ethnic inequality. Distributional equity hence cannot be given a lower priority than economic growth in the process of peace consolidation. Such a stance may be less controversial than in the past as recent studies have revealed that the two objectives of growth and equity tend to reinforce each other (e.g. Alesina and Rodrik, 1992; Alesina and Perotti, 1993; Persson and Tabellini, 1994). This relation between social tensions and growth works in two ways. Sachs (1989) for instance highlights linkages between social conflict and poor economic outcome. In the case of Latin America, he shows that high income inequality contributes to bad policy choices and weak economic performance *via* intense political pressures for macroeconomic policies to raise the incomes of lower income groups ("populist" policies).

Some analysts have recently suggested that contemporary conflicts can be better understood if considered as a logical outcome of the struggle between different social groups for access to - and control over - resources such as land and humanitarian aid as well as trading routes and activities (Keen, 1997; Rufin, 1995; Jean and Rufin, 1996). The objective of warring parties is not invariably to seize power and gain control over the state, but may also be more narrowly economic, as exemplified at certain stages in Liberia or Sierra Leone. Keen (1997) underlines that even if war is costly and seems irrational with regard to the society as a whole, it is usually a very profitable business for the particular groups who can secure control over resources and draw benefit from them. King (1997) also highlights how war can be profitable for specific groups. He adds that leaders may have a direct personal interest in continuing the war as they are bound to lose power through negotiated peaceful settlement. Ownership and distributional issues thus often lie at the heart of violent aggressions.

From the above, it clearly appears that most researchers feel that reducing income and asset inequalities is of prime importance as it strongly contributes to lessening tensions and strengthening political stability. However, it may be argued that postconflict situations often require a more cautious approach. In specific circumstances, redistribution in favour of the poorest may provoke a violent backlash in the aftermath of a civil war: former combatants, impoverished middle class representatives, and former economic elites are often politically more vocal than the poor (see also Haggard and Webb, 1994: 23-25). If they feel threatened by redistribution policies, they may defend their interests with unexpected violence. In other cases, those who hold large assets may agree to allow some fiscal redistribution to protect their own asset holdings against renewed violence in the medium to long run. A fundamental challenge for policy makers is thus how to accommodate pressing demands for more equity while avoiding at the same time a resurgence of violence. To this end, distributional issues should not be confined to income gaps or differences in wealth only. In postconflictual situations, inequality should be assessed in the much wider context of individual and collective power, entitlements, rights and obligations, access to public services and privileges, etc.

Development, Inequality and Peacebuilding

As pointed out in the introduction, the great majority of contemporary war-torn societies rank among low-income or lower-middle-income countries. The relationship between economic development, inequality, and violence has been analysed by various authors in recent socioeconomic studies on conflict and peace, as will be briefly reviewed in this sub-section. The relationship between *development and income concentration* has been subject to much scrutiny. This body of literature goes back to the pioneering work of Kuznets in 1955, when he suggested that the income gap widens during the initial stage of development and then narrows in later phases. The relationship between income concentration and per capita income growth would be shown in graphic terms as an inverted U-shape (the so-called "Kuznets' curve"). There has however been controversy whether the underlying relationship may be rather J- than U-shaped in some countries. Empirical evidence has generally confirmed Kuznets' assumption with regard to industrial economies (e.g. Brenner *et al.*, 1991), although other analysts contend that rising inequalities in today's industrial and developing economies contradict Kuznets' optimistic predictions (e.g. Gupta, 1990: 266). Nonetheless, while comprehensive time series data on income concentration is not available for Third World countries, empirical analysis has produced results that are consistent with Kuznets' theory. Houweling (1996: 151) finds that during the onset of intensive economic growth, when countries move from low-income into middle-income economies, the inequality gap tends to enlarge, the share of income accruing to the bottom quintile of society falling at the same time as the emergence of new centres of wealth[15]. Then the gap between the ratio of income share accruing to the poorest and the richest quintiles tends to narrow again in the case of high-income economies taken as a group. Evidence from the study by Alesina and Perotti (1993) mentioned earlier confirms that income inequality may increase socio-political instability, thus revealing a positive correlation between an economy moving along the Kuznets' curve and the level of political violence. Instability reduces investment by increasing political and economic uncertainty in an unpredictable environment. Since investment is a prime engine of growth, the consequence is an inverse relationship between income inequality and growth. Results obtained by Rothgeb (1990) in another cross-national study involving 84 developing countries between 1976 and 1983 reaches similar results[16].

Significant differences between contemporary late-comers in development and the experience of early industrialising Western countries may help to explain the high incidence of war among low-income countries today. Houweling (1996: 152-155) compares the timing of sharp increases in life-expectancy and population growth with the respective position of early and late-comers in development on the Kuznets' curve. In early European developers, improvement in life-expectancy and education as well as high population growth rate coincided with decreasing income inequality. In sub-Saharan Africa, on the contrary, most countries have lost per capita income in the last decades, or have experienced higher income concentration in a region experiencing the highest regional population growth-rate in the world. Houweling suggests that this, combined with exposure to mass media which depicts both domestic and international wealthy, high-status living standards, may sharpen the widespread feeling of relative deprivation. Besides, "development late-comers" must cope in a relatively more limited time-frame with increasing challenges linked with the processes of modernisation and democratisation (Van de Goor *et al.*, 1996: 21).

IV.2 Institutional and Human Resource Challenges

Conventional economics have little to say about the process of institutional change upon which depends much of the success of transition from war to lasting peace. However, the international community now tends to recognise that institutional (re)building is at least as important as the more obvious reconstruction of physical infrastructure (OECD, 1997; World Bank, 1997a). Rehabilitating institutions may even be more urgent than rebuilding physical infrastructure since their functioning is essential for the restoration of a minimum confidence, stability and predictability, without which any attempt to restart formal economic activities is likely to fail. This statement, however, needs to be qualified. In countries affected by civil war such as Guatemala, institutions have been maintained during the conflict, but the problem is that they have lost legitimacy. The main challenge is then not to rebuild public institutions, but rather to restore citizens' confidence in them (WSP, 1997c).

The New Institutional Economics (NIE) may provide theoretical and conceptual guidance to study this complex set of issues. In this approach, *institutions* are understood as defining and limiting the set of choices of individuals in the jargon of economists (North, 1990: 4-5). They are the formal and informal "rules of the game" presiding over human interaction and exchange. They include all the rules that can constrain behaviour in a certain field and create behavioural regularities, including firms, families, contracts, markets, social norms, etc. (Lin and Nugent, 1995: 2303-2307). Kumar (1997: 25) specifies that "institutional infrastructure includes legal or customary rights defining ownership of private property, contracts and their enforcement, and rules and regulations governing business transactions. The basis of institutional infrastructure is the expectation that the interacting parties will fulfil their respective obligations".

North (1990: 89-90) notes that discontinuous or violent changes are likely to appear when institutional contexts render it impossible for players to make new bargains and compromises and cannot provide a suitable framework for evolutionary change. When parties to an exchange have no space in which to settle disputes, violence may be the only alternative. Institutions are meant to "reduce the uncertainties involved in human interaction" by establishing a stable (but not necessarily efficient) structure to human interaction (North, 1990: 25). In the case of war-torn societies, institutions are usually weak or have simply collapsed. As argued above, uncertainty and risk often reach prohibitive levels. Reforming the security and judicial sectors and/or restoring confidence in them thus ranks among top priorities with a view to restoring sustainable economic activity.

Besides institutional weaknesses, human capacities often do not match the requirements of competing demands by different groups for reconstruction in the aftermath of prolonged civil conflict. The public and private sectors are usually faced with a critical shortage of trained personnel as skilled employees have left the country or are lured away to take up better-paying jobs in international agencies. In addition, education and training institutions have probably decayed during the war. In some cases, the intelligentsia and leading sectors of the civil society have disappeared as a result of systematic persecution. At an operational level, international organisations such as ILO, UNHCR, UNIDO and FAO have analysed these issues in the framework of their mandates and have devised specific programmes for postconflict countries.

Recent research conducted in Eritrea illustrates this well. It emphasises the relative discrepancy between labour demand and supply: "Eritrea is in urgent need of skilled labour for rebuilding_ yet, the necessary human resources are not available. This is due in part to the large number of skilled workers killed during the war. It is also due to emigration and the physical destruction of industry, which forced many people to look for work outside their area of expertise ... Thousands of laid-off civil servants, demobilised combatants and returning refugees have all aggravated the situation, since many do not possess the skills now in demand in Eritrea's expanding economy." (WSP, 1997b: 9).

It has been noted that in many instances, a sharp reduction of civil servant wages due *inter alia* to stabilisation packages further increases incentives for corruption and bribery in the public sector, which in turn threatens the legitimacy of institutions and heightens insecurity. According to Mbembe (1994: 40-44), this contributes to a dangerous acceleration in regression of the state in several African countries and leads to the privatisation of violence. This process, often referred to as "state failure" or "state regress", may contribute to outbursts of anarchical types of war such as those that Africa recently experienced.

Development, Institutional Changes and Peacebuilding

In its 1996 Report, the Development Assistance Committee (OECD, 1996: 51-52) states that "social and political dislocations are inevitable in the process of development in any country. The structural transformations required for economic modernisation disturb established patterns of production and distribution of income and wealth, often leading to shifts in the balance of political power amongst different social groups... If there are no effective structures and mechanisms to address the claims of affected groups, alleviate the impact of structural change, and ensure that the benefits of development are widely shared amongst the various sections of society, such friction can escalate into violent conflict".

Social scientists have analysed how abrupt institutional changes resulting from the economic development process itself may threaten fragile peace. But the relationship between economic development and conflict is ambiguous, and development has been referred to as a "double-edged sword":

Londregan and Poole (1990) find a negative relationship between growth and military coups, based on political and economic data from 121 countries between 1950 and 1982. Their findings underscore the risk of a vicious spiral of "poverty" and "coups d'état": low levels of income and low growth rates increase the probability of a coup, and countries with more past coups are more likely to experience yet another coup[17]. On the other hand, it has been argued that positive economic development might have several destabilising consequences. Houweling (1996: 143-169) describes the process of development as a transition from a social order in which power has accrued to the fighter and his organisation to another system in which market relations as well as consumption and production organisations predominate, which is particularly relevant to postconflict countries. Development further involves a change in the relationship between the state and its people with a transition from a system of clientelism or patronage to more impersonal and bureaucratic relations.

Mbembe (1994: 39-46) argues that in the case of Sub-Saharan countries where the state used to reward its political base generously for continued support, declining terms of trade coupled with the tight budgetary constraints and privatisation often imposed under structural adjustment programmes have curtailed the capacity of political elites to satisfy their supporters. The resulting changes in power and entitlements between different groups threaten political stability, especially when these shifts take place over a short period of time. The challenge thus consists of including aspiring elites into the political system without losing the support of the more conservative elites that may still have considerable power.

These issues should not be overlooked when designing economic rebuilding policies. For the low level of institutional capacity often found in postwar states to manage the profound structural changes associated with the development process increases the likelihood of a resurgence of armed conflict. This is all the more important in that countries with deeper social divisions and weaker institutions for conflict management are likely to experience greater economic decline in response to external shocks, as forcefully argued by Rodrik (1997).

13 As Lichbach (1989: 431-440) rightly points out, analysts with different skills and background have adopted different approaches. In 1987, Muller and Seligson used logged ordinary least-squares (LOLS) to estimate the effect of income inequality on cross-national levels of deaths by political violence. They found evidence supporting a substantial correlation between inequality and political violence. Wang (1993) challenged the robustness of this conclusion arguing that in the case of event count data, the application of the exponential Poisson regression model (EPR) was more appropriate. Using EPR, Wang concluded that political regime structures and intensity of separatist movements were more important in explaining the occurrence of political violence. In their response, Dixon, Muller, and Seligson (1993) argued that in most cases, applying the two approaches (LOLS and EPR) yielded similar results confirming significant correlation between inequality and political violence.

14 Other authors have suggested that studying the origins of expectations can help understand the rationale for conflict: norms, social comparison processes, ideologies, etc. (Lichbach, 1989: 457). Adelman and Robinson (1989: 950-960) showed that opportunities for "exit" through international or rural-urban migration made greater inequality more tolerable, and that the same holds true if the richest groups refrain from ostentatious display of wealth differentials.

15 On the basis of available data from the *1994 World Development Report,* the ratio of the income share of the poorest quintile to the share of the richest quintile for 19 low-income economies amounts to 0.14, comparable with the average score of 0.14 for 17 high-income economies. The average share of the top quintile income earners is 47.2% and 40.8% respectively. (The dispersion between low-income countries is much larger than for developed countries). But the average share of the top quintile income earners in lower-middle and upper-middle-income economies is 51.9% and 54.6% respectively, while for the bottom quintile, the average shares are 5,4% and 4,4%, which is compatible with Kuznets' curve.

16 Rothgeb (1990) traced a positive correlation between political conflict and stocks of foreign direct investment in mining and manufacturing. He found that political

violence (demonstrations, strikes, etc.) tends to intensify in richer developing countries with higher levels of income concentration after a time delay of six years. The author however indicates that the tendency to conflict escalation with higher level of foreign direct investment in wealthier developing nations is counteracted by a generally more moderate level of government repression than in poorer countries.

17 Londregan and Poole build both a model of coups and a model of income. They find that while the effect of income on coups is pronounced, there is little evidence of feedback from coups to income growth.

V. Recommendations Emerging from the Literature

Several authors stress the importance of a coherent and integrated approach between politics, economics and the peace agenda. More specifically, there must be careful consideration of the implication of economic policy choices for political stability, the consolidation of peace and the survival of a new coalition government that might emerge together with the establishment of peace: "Certainly, concern for the survival of fragile democratic institutions and achievement of the political stability needed to preserve a newly won peace suggest that the World Bank and the International Monetary Fund should be particularly careful about the policies upon which they insist as a condition for their participation in the reconstruction of all these war-torn regions" (Lake, 1990: 21).

The recommendations formulated so far by economists for improved postconflict rebuilding policies tend to be directed primarily at the international community, mainly the international financial institutions, relief agencies and key donors, rather than at domestic actors. These recommendations, briefly presented hereafter, mainly focus on (i) the delivery mode and impact of external assistance; (ii) the appropriate content and pace of economic policy reforms for war-torn countries; and (iii) political and economic conditionality.

V.1 External Assistance

Donors can do much to lessen the human and economic costs of conflict even during the hostilities. Major international actors have come to officially recognise the pressing need to bring together emergency aid and longer-term development efforts and integrating them in a coherent and co-ordinated framework (e.g. OECD, 1997). Accordingly, the costs of protracted war should not be increased by delaying or holding back on investments in social and economic development until peace is firmly installed. Based on the findings of empirical surveys on the costs of war, it is generally recognised that economic and social policies during the war should be directed first and foremost at protecting food and health entitlements. To this end, an important requirement is to avoid a collapse in fiscal revenues, for social and economic expenditure is likely to be negatively affected before military expenditure. Stewart (1993) stresses that strong government structures with sufficient revenue to support the provision of essential social services are crucial to avoiding the large numbers of indirect deaths associated with war.

It has been widely suggested that the international community should assist governments in countries at civil war to maintain key institutions in the social and infrastructure sectors with a view to reducing the costs of internal war. It should also help sustain public revenues with counterpart funds and, as far as possible, improve export earning through trade promotion initiatives. Economists such as Stewart *et al.* (1997) argue that development efforts are a waste of resources only if new projects are likely to be immediately destroyed. They conclude that development efforts should continue during war. Other analysts however warn that foreign assistance may actually sustain the conflict by preventing the collapse of the government under attack, or may even feed the war, and cannot be regarded as neutral. Therefore, the political implication of economic and humanitarian assistance should be carefully and systematically assessed to avoid potential negative side-effects.

In this context, an abundant literature on external assistance is emerging from concerted efforts by the international community to improve aid effectiveness and delivery as well as to contain negative "by-products" of external assistance (e.g. Anderson, 1996; Ball, 1992; Ball and Havely, 1996; Millwood, 1996; OECD, 1997). Best practices for postconflict reconstruction include (i) rebuilding or strengthening domestic institutions and working through local structures; (ii) involving beneficiaries in project design and implementation; and (iii) avoiding the creation of high expectations that cannot be met. The OECD/DAC guidelines (1997) call for the participation of national and local authorities in programme design and implementation. Duffield (1994: 50-69) argues that international efforts must be geared toward a search for local solutions and that postwar policies, including economic policy, must be premised upon the centrality of indigenous political relations. Therefore, foreign agencies must improve their understanding of the political economy of complex emergency situations before getting involved[18].

V.2 Economic Policy

The recommendations on macroeconomic management contained in the OECD/DAC guidelines on Conflict, Peace, and Development Co-operation are largely inspired by the IMF. They advocate the preparation of a Macroeconomic Reconstruction Framework by the government and a lead external agency as early as possible in the course of peace negotiations. This document could be similar to the policy framework paper produced for low-income countries which receive financial aid from the IMF, but would cover a shorter time span. In this context, capacity building for economic policy-making and the management of public finance is a priority (OECD, 1997: 51). The OECD/DAC guidelines also recommend the ensuring of consistency between reconstruction costs, the sum of resources likely to be available and a country's absorptive capacity. Basic expenditure required for peacebuilding and reconstruction are recognised as a priority, but the resulting public expenditure should be accounted for within a budget "consistent with (i) an available external budgetary and project support in line with the country's debt servicing capacity (taking into account that donor funding is likely to taper off over time); and (ii) domestic financing that is non-inflationary and does not pre-empt the capital needs of the emerging private sector." (OECD, 1997: 51).

In a major study on the role of the IMF in Mozambique, Hanlon (1996) proposes to set alternative benchmarks for reforms in postconflict countries. In the case of this country, the international community should take the following steps: (i) to write off debts; (ii) to end donor corruption (bribery); (iii) to back the productive sectors; (iv) to support existing national structures rather than by-passing them; and (v) to cut technical assistance which is very costly and not adapted to actual needs, and put the money saved into higher salaries in the public sector. Hanlon also makes specific suggestions to the Mozambican Government: (i) to launch an anti-corruption drive; (ii) to streamline administrative requirements and the tax system in order to push the informal sector into the formal one; and (iii) to show more generosity to the losers and direct more money to the poorest areas (often under Renamo's influence).

Other economists insist that non-price factors should be better integrated into policy making. For war can result in sudden and destabilising changes in employment, production and prices. The ensuing collapse of market entitlements for large groups of people makes it highly dangerous to rely exclusively on the market to allocate resources, set prices and fix factor incomes (Nafziger, 1996: 45-47; Stewart, 1993: 375-379). The example provided above in the sub-section on agriculture has shown that the lack of a stable and predictable environment coupled with institutional weaknesses may frustrate expected benefits from price incentives[19] and that the usual policy package advocated by the international financial institutions may be inappropriate in the case of countries at war.

Price adjustment alone cannot correct the fundamental disequilibria affecting economies at war. FitzGerald (1997: 46) argues that economists should not assume that the economy is moving from one equilibrium towards another: first, a large portion of resources are administratively allocated (i.e. on non-market criteria) to the material requirements of the military effort; second, some administrative allocation of imports and foreign aid to national priorities cannot be avoided during wartime in order to cope with a substantial deterioration in the balance of payments. The expenditure-cutting policies of most adjustment packages curtail the capacity of government to maintain basic economic and social functions on top of the drains of military expenditure. In what might represent the most original and comprehensive proposal for alternative economic policy, FitzGerald (1997: 58-63) suggests a different approach to stabilisation policy for low-income economies at war. The main policy recommendations, inspired by Keynes' proposal in 1939 on how to pay for the war[20], are articulated as follows:

In the case of low-income countries, the first priority should be to restore the exchange relationships between the rural peasantry and the urban poor. Rapid postwar recovery should thus derive from investment in rural areas. Industrial production and import support programmes ought to be diverted toward the supply of agricultural producer goods and appropriate rural consumption goods accompanied by equivalent products for urban artisans. Aggregate output could thus increase within the foreign exchange constraint and food prices could be kept under control. As it is notoriously difficult to increase direct taxation rapidly in war-torn countries, duties could be collected on imported durables, gasoline, electricity, bottled drinks and cigarettes. Foreign aid should finance small-scale rural investment and assist in the swift rehabilitation of the transportation and commercialisation systems. Peace conditionality could involve the suspension of official debt service during periods of conflict if a poverty-oriented stabilisation programme is implemented, and debt cancellation in exchange of the establishment of sustainable peace.

In the medium to long term, strengthening the domestic business sector is a prerequisite for job creation and growth. For Monga (1994), the private sector in Africa should better organise and use its political and financial resources to push for more democracy and political stability, which may in turn strengthen the business community in the Continent. Attali (1997: 132) also proposes to strengthen the business sector to prevent conflict, especially in former centrally-planned economies. He suggests *inter alia* to finance small businesses by transferring credit lines to local banks for loans as small as US $100 in order to create jobs. He further calls for an increase in technical and financial assistance for the setting up of institutions fostering economic integration between countries, such as common free trade areas. In an ILO study focusing on financial institutions in conflict affected countries, Nagarajan (1997) argues that traditional approaches to developing micro-finance institutions are not applicable to countries like Cambodia, Mozambique and Somalia. The author concludes that developing financially sustainable institutions is both possible and necessary, but may take more time and effort compared to normal developing countries.

V.3 Conditionality

The issue of aid conditionality in the framework of postconflict rebuilding give rise to lively debates. Conditions attached to the delivery of foreign assistance to Bosnia and Herzegovina were a recent and much publicised example. Boyce and Pastor (1997) suggest that external actors must formulate appropriate conditionalities if aid is to support the peace process and attract or "crowd in" domestic resources for peace-related requirements. They argue that in the case of El Salvador, the international community has failed to exert effective peace conditionality whereas it has pressed more forcefully for macroeconomic reforms. The international financial institutions have weakened the consolidation of peace by being both too rigorous on public expenditure reduction and not rigorous enough on the reallocation of domestic resources from military to the new democratic institutions as well as on the timely implementation of the land transfer programme. For these authors, the reinforcement of power sharing and democracy is a priority in the wake of a negotiated settlement to a civil war.

Sandbrook (1996) argues that the international financial institutions have assumed unprecedented responsibilities by seeking to create the economic and administrative conditions for recovery. They should also contribute to peace consolidation by promoting governance reforms that allow greater participation of the society at large in the formulation of economic policy. This would contribute to reducing tensions and inequalities by encouraging a more progressive tax system and less regressive expenditures. FitzGerald (1997: 63) implicitly wonders whether certain United Nations agencies would not be better suited than the IMF and the World Bank to exercise policy conditionality in conflict situations. In the same vein, other analysts suggest that the international financial institutions are too narrowly focused on economic considerations. Ball (1996: 176-177) recalls that it is the official policy of both the World Bank and the IMF not to apply specific military-related conditions to their lending, although they might have done so upon several occasions. She concludes that adding their voices to policy dialogues with aid recipients would increase the impact of external conditionality. Lake (1990: 23-27) calls for the creation of a reconstruction fund to be administered by multilateral institutions rather than bilateral ones. Conditionality attached to it could include continued respect for peace accords, the observance of human rights and good governance in addition to reduction of poverty, respect for the environment and promotion of democracy.

It is striking to note the relative paucity and weakness of recommendations addressed to the domestic actors of reconstruction. There might be cultural, political, financial and other reasons behind this. Nonetheless, the eventual success of rebuilding efforts after an internal conflict primarily depends on all the domestic actors involved. It is therefore high time for the international community to translate its official commitment to place national and local authorities at the heart of rebuilding strategies into practice, rather than systematically by-passing them as tends to be still the rule in countries like Mozambique.

18 With regard to the planning and timing of foreign aid, FitzGerald and Mavrotas (1994: 17-18 and 47) suggest that rehabilitation flows should be planned well in advance, for emergency relief and unanticipated aid flows tend to be fully consumed whereas 30-40% of anticipated aid is usually saved by the recipient country and can be then reinvested (according to calculations by Levy, 1987).

19 It has been argued that structural adjustment may fail to promote agricultural production and non-traditional export in the aftermath of a war, for often peasants often may not increase their production even when food prices rise because of insecure tenancy, increased transaction and litigation costs linked to insecure property rights, an inefficient marketing system, destroyed infrastructure, obsolete production assets, and lack of access to credit.

20 Keynes proposed establishing obligatory savings schemes for workers with a view to absorbing excess demand during the war while allowing the building up of financial assets for rebuilding once the war is over (Keynes, 1939, 1978).

VI. Conclusion and Future Directions

Economic research on contemporary countries at war and postconflict reconstruction is an extremely complex and somewhat novel area for scholars and practitioners alike. Dealing with such issues requires greater dialogue and understanding between a multiplicity of actors and institutions with different backgrounds, perspectives and objectives. It is evident from this review of the literature that there is no blueprint or tool kit for rebuilding war-torn societies. The rationale and dynamics underlying each and every conflict have to be clearly understood in designing appropriate responses.

Before turning to a final assessment of the literature, it should be underlined that postconflict challenges are not limited to reconstruction. Postwar countries face the immense task of (re)integrating into the global world economy. Peace being settled, they have to strive to become gradually able to compete effectively on world markets and promote their interests in the economic and trading system. This is more arduous now than it was decades ago, as the process of world-wide liberalisation and technological progress has accelerated. While many war-torn societies have fallen prey to the internationalisation of criminal and purely speculative activities, they are in a much more difficult situation to seize potential benefits from the current global economic context, abundantly referred to as "globalisation". Even if the challenges related to "globalisation" were not explicitly mentioned in this literature review, they must be taken into account as they provide the general background against which contemporary postconflict economies have to rebuild themselves.

Throughout this paper, it has been highlighted that economic analysis of conflict and postwar rebuilding raises a set of basic issues that should be addressed as a priority. It has further been suggested that some of these issues have been largely overlooked. In this concluding section, the author of this paper first makes an assessment of the main debates that emerge from the economic literature reviewed, and then turns to the strengths and weaknesses of recent research in order to indicate those areas that would merit more attention. Finally, the author suggests directions for further research.

The paper analyses major debates among economists, as well as between them and other social scientists. As remarked earlier, discussions are primarily led by external actors and Western scholars. Subsequent recommendations are directed at international organisations involved in postconflict countries rather than at the domestic actors of reconstruction. However, it has been rightly argued that postwar rebuilding relies primarily on national actors, for reconciliation among them is a prerequisite for sustainable peace and development. One of the key components of any reconciliation process is the restoration of the institutional and human potential for peaceful management of competition and conflicts. The focus of attention should thus shift to domestic actors and involve them in research on - and design of - locally accepted solutions.

Debates chiefly centre round the interactions between peacebuilding on one side and on the other: (i) economic policies or structural adjustment; (ii) external assistance; and (iii) aid conditionality.

Economic Reforms versus Peacebuilding

The debate on *economic reforms versus peacebuilding* tends to become less controversial. Few structural adjustment critics would deny the desirability of macroeconomic stability and reasonable fiscal and monetary policies, even in the aftermath of civil strife. On the other hand, international economic institutions, and the World Bank in particular, have come to recognise the need to tailor appropriate programmes for each war-torn country so that adjustment policies do not frustrate, but enhance peace efforts. Indeed, the Bank and other multilateral or bilateral agencies have taken concrete steps to strengthen their capacity to deal with postconflict situations more effectively. There has been some progress in this regard when comparing postwar policies in El Salvador between 1991 and 1995 (Boyce, 1996) with Guatemala today (see below). But one may question how far large institutions with different cultures and mandates are committed and able to translate new guidelines and official commitments into operational reality in postconflict countries.

External Assistance

As for the debate focusing on *external assistance*, recent lessons are being drawn and best practices established. One of the most important findings relates to the necessity of adapting aid and its delivery to local circumstances and of involving domestic actors in the design and distribution of externally-funded assistance, with a strong emphasis on the strengthening of local capacities. This very simple and basic stance appears much more difficult to implement at the operational level however. It requires a major shift in long-established practices and mentality among donors and international agencies. Serious commitment and political leadership are thus still necessary.

Peace and Economic Conditionality

Lastly, discussions on *peace and economic conditionality* are ongoing. Effective conditionality obviously requires concerted efforts by the international community and presupposes some consensus on the objectives of - and criteria for - conditions attached to aid, together with improved transparency between donors and recipients. In this context, it is encouraging to note that IMF Director General Camdessus publicly declared, on a visit to Guatemala in May 1997, that the principal requirement attached to financial assistance was the timely implementation of the Peace Accords signed in December 1996, implying that there was a close parallel between peace and economic conditionality in the case of Guatemala.

These debates among economists consider important rebuilding issues and certainly contribute to improving the capacity to design appropriate economic policy and rebuilding strategies. But their focus reveals a relative neglect of more fundamental questions that are either taken for granted, or simply ignored as they do not fit into the prevailing paradigm:

Their is a tendency to study postwar countries only once - or as if - some sort of "normalcy" had returned. This may be partly as a result of the methodological difficulties highlighted in the introductory section. Political stability is generally taken for granted even if reality often contradicts this assumption. Epistemologically, this derives from the fact that traditional neoclassical economic theory holds the socio-political environment constant and pursues the objective of optimum allocation of resources under the *ceteris paribus* assumption. But the fact is that economic reform and rebuilding efforts will be in vain if conflict flares up again. What is thus suggested here is that absolute priority should be given to political stability in the aftermath of civil war, even if this means sub-optimal economic efficiency.

Neoclassical economics assumes that economic actors are rational individuals who merely seek to maximise their profits or utilities (*homo economicus*) under a given set of constraints (social, economic, moral, legal, political, etc.). But in a civil war context, the behaviour of groups and individuals is not often economically rational. War-affected groups may react to economic incentives on purely emotional or tribal grounds, which is very different from what would be expected from *homo economicus*. Integrating this dimension in research requires a wide, multidisciplinary perspective.

Neoclassical economics puts exclusive emphasis on equilibrium analysis as it assumes that market forces are always driving the economic system toward an equilibrium. However, many challenges inherent in postconflict situations may cause large and sudden disequilibria that cannot automatically be resolved. This paper has indicated several factors that are quite beyond the control of the domestic authorities and economic policy makers, such as the impact of huge and relatively unexpected movements of population, the reintegration of ex-combatant and refugees, a largely uncontrolled influx of remittances from emigrants and a mismatch between labour skill supply and demand. These factors may durably alter market equilibria. It has further been mentioned that large portions of the population are often driven outside the formal economy as a result of survival strategies. One may add to this list the impact of pervasive intervention by external actors on domestic markets and politics, often coupled with an erratic evolution of external assistance flows.

How to integrate such determining factors in economic research on conflict and reconstruction remains an open question. It has been argued that institutional economics and the political economy approach can both contribute to this endeavour (section III.6 and III.7). However, substantial efforts in this direction are still required and further research is urgently needed to improve the contributions of economists to peacebuilding and reconstruction efforts.

Based on this review of recent literature, the author suggests intensifying research in the following areas:

First, systematically assess the distributional impact of economic policies - notably fiscal and trade reforms - as equity issues often play a critical role in the restoration of peace (see sections II.2. and IV.1). This would help to identify potential winners and losers from postwar rebuilding and to design alternative or compensatory measures as appropriate. The typical lack of reliable data on postconflict economies as well as the difficulty of controlling the large informal sector which usually develops during war makes it necessary to devise innovative approaches and resort to analytical rather than applied models. As a data system, social accounting matrices (SAM) can provide a simple and effective framework to ensure consistency between - and reconcile -

different data sources. It can further serve as a basis to assess the distributional incidence of economic policy options.

Second, research should be undertaken to improve understanding of the political economy of rebuilding contemporary postconflict countries, particularly in low-income and low-middle-income countries, at different stages of democratisation. The importance of the political economy of postwar rebuilding has been stressed in section IV, including the behaviour of - and interactions between - the main actors involved in policy design and implementation. It has also been underscored that aside "objective" variables, the subjective perceptions that economic agents have on reconstruction prospects should be subject to much closer scrutiny as they appear to exert a decisive influence on rebuilding processes. Research drawing on the theory of endogenous economic policy (e.g. endogenous trade and fiscal policy) may contribute to taking into account the different forces at play in policy formulation and implementation.

Third, the complex set of interactions between economic reforms, institutional/political structures and conflict should be examined more systematically to design appropriate policies in a global perspective. Several issues raised in this review of the literature provide a valuable background for this. It has for instance been underscored that democratisation may increase the influence from poorer groups within society and thus favour the adoption of economic policies that help reduce economic inequality and strengthen peace. But it has also been contended that it may unleash violent opposition forces and increase tensions.

The relationship between property rights (land ownership) and political structures has considerable influence on rebuilding prospects. It has been mentioned that the cost of private enforcement of property rights can be prohibitive for individuals in the context of widespread insecurity. Further research on economic rebuilding based on the new institutional economics would contribute to a better understanding of the impact of transaction costs and the particular institutional challenges related to postconflict situations.

Fourth, the current process of state collapse in several war-torn countries deserves particular attention. More specifically, it has been argued that economic stabilisation policies may contribute to accelerating state regression and the fragmentation of violence, leading to anarchical types of protracted conflict. In fact, the number of low-income countries subject to widespread violence, corruption, banditry and collapse of public institutions has been causing increasing concern (section IV.2; see also UNCTAD, 1997: 125-148; Zartman, 1995). Strengthening peace and rebuilding the economy in the absence of a minimal state apparatus poses major challenges to economists and the international community alike. Such situations call for innovative approaches to be worked out in conjunction with local and regional actors.

Rebuilding war-torn economies implies taking into account all intertwined variables that may simultaneously interact with the consolidation of peace (e.g. economic, humanitarian, political, historical, religious, ethnic, environmental, etc.) as well as different types of interventions by local, national, regional and international actors. The challenges of economic rebuilding calls for multidisciplinary research that goes far beyond mere contributions from experts in different disciplines. It requires profound and structural multidisciplinarity as defined by the economist Paul Streeten, i.e. integrating the concepts, models and paradigms from one discipline into the analysis of another. The pressing and mounting requirements for global research on economies at war and postconflict reconstruction provide an opportunity to make rapid progress in this direction.

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