BUILDING DEMOCRACY AND THE MARKET ECONOMY IN POST-CONFLICT SOCIETIES

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CIPE is an affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy
Post-conflict reconstruction

- Transition to peace through rebuilding socio-economic framework of society
- Reconstruction of enabling conditions for building democratic institutions, governance, and market economy
- Three-phase transition from emergency phase toward sustainable economic development
  - Emergency phase (peace onset) of 4 years + two other 4-year periods (capacity building)
  - The need for unique development assistance during those phases
The importance of post-conflict reconstruction

• The increase of the volume of post-conflict aid
  – 17% of IDA grants (2003)
  – In order to reach the Millennium Development Goals (MDGs) post-conflict funds need to be increased from $136 billion in 2006 to $195 billion in 2015

• Humanitarian aspect: 90% of conflict causalities are civilians
  – Loss of human capital cripples the economy
  – Divided societies need both financial resources and policy advice
The areas of post-emergency assistance

• Repairing and building new physical infrastructure
• Creating institutional infrastructure to support economic growth
• Managing the existing institutional gap
  – The need for sequencing policy reforms: social, structural, and macroeconomic
• Budget support for investment in infrastructure
• Aid to productive sectors (often neglected)

It is crucial to set sound and realistic aid objectives.
Common challenges to reconstruction assistance

• Aid objectives and methods
  – Lack of clear definition and coordination
  – Exit strategy, local ownership, and local participation not well addressed

• Aid sequence and phasing
  – Aid comes too early and tapers off too soon, creating discordance with absorptive capacity

• Transparency and accountability
  – Inadequate monitoring and evaluation
  – Inadequate feedback and information flows
Absorptive capacity and its constraints

• Absorptive capacity is the ability of a country to efficiently accept and apply outside assistance
  – Policy and institutions matter for the returns from aid in terms of economic growth
  – There are diminishing returns to aid
    • Saturation point equals 15–45% of GDP
    • Marginal benefits beyond that point become inexistent or even negative

• Absorptive capacity constraints
  – Macroeconomic, institutional & policy, technical & managerial, donor behavior
Macroeconomic constraints

- Large inflows of aid and the “Dutch disease”
  - Dutch disease leads to appreciation of local currency
    - Same phenomenon as in the case of windfall cash flows from discovery or price hikes of natural resources
  - Dutch disease has negative effect on exchange rate and competitiveness of exports
- Debt sustainability and debt burden
- Rising inflation and high interest rates
- Labor market pressures (skills and wages)

Overvaluation of the local currency fueled by massive aid inflows during post-conflict reconstruction reduces catch-up growth.
Institutional and policy constraints:

Capacity

- More capacity needed to formulate and implement credible strategies, policies, programs
- Challenges of transforming high levels of post-conflict aid and scarce public resources into positive development outcomes
  - Little job creation and income generation
- More transparency needed in budget systems
- Inadequate patterns of public expenditure
Institutional and policy constraints:

Accountability and Responsibility

- The need for a degree of decentralization of reconstruction resources, efforts, and responsibilities
  - Mechanism for definition of policy priorities and accountability systems to hold governments responsible
- Insufficient institutional capacity of a recipient country increases aid dependency
  - Negative incentive for reforms
  - Shift of responsibility from local government to international actors
Institutional and policy constraints:

Country Assessments

- Country Policy and Institutional Assessment (CPIA)
  - The World Bank’s diagnostic tool meant to capture the quality of policies and institutional arrangements
  - Rates 16 criteria within four clusters:
    - Economic management
    - Structural policies
    - Policies for social inclusion and equity
    - Public sector management and institutions
  - Scores are averaged on 1 (low) to 6 (high) scale
- Average CPIA scores during the three 4-year phases of post-conflict transition
  - Peace onset 2.50; I period 2.82; II period 3.05
Technical and managerial constraints

- Low quality of human capital and education
  - Not enough human resources to accelerate development
- The need for technical assistance and training
  - Build upon what already exists on the ground
  - Support learning vs. training (match training needs)
  - Provide on-the-job training
- The need for a critical mass of people who understand the country’s development challenges and can hold the government accountable
  - The government must be accountable for transforming public spending into improvements in the standard of living
Donor behavior constraints

- Fragmentary donor interventions
- High transaction costs
- Lack of cooperation with local actors on needs assessments, setting objectives, and benchmarking
- Many small, dispersed projects that are uncoordinated and burdensome to administer
- Lack of certainty and predictability concerning the future volume of aid
- Lack of donor cooperation in ex-post evaluation of aid effectiveness
  - Hampers learning from feedback
Ways to improve capacity

• Options to create better absorptive capacity
  – Build capacity (start early in the onset phase)
  – Buy capacity
  – Build temporary capacity
  – Bypass weak government capacity

• Local ownership of reform matters

Building local capacity in post-conflict countries helps ensure local ownership in the reform process, which is crucial for the success of the reconstruction efforts.
The importance of local ownership of aid-sponsored projects

- Building domestic capacity for reform
  - Ensure local ownership
  - Avoid imposing institutional models from the outside
    - Distorts local initiatives for reforms

- State building / Institutional building
  - Balance the power of government
  - Bring civil society and business into the reform process
  - Stimulate political competition, create checks & balances
Political parties and local institutions

- Political parties in post-conflict areas need to represent the interests of larger social groups rather than just closed elite circles.

- Political parties have an important role in building institutions:
  - Parties need to build greater role for and capacity of the parliament.
  - Parties should not be proxies for divvying up power in the government.
  - Parties should support practices leading to the emergence of visionary and accountable leadership.

“Institutions can’t be transferred wholesale.”
- Douglass C. North
The role of private sector and business community

– Local business communities in post-conflict countries can contribute to overcoming obstacles to growth and development such as:
  • Unfair competition
  • Weak rule of law and corruption
  • Limited channels for the private sector to have a voice in shaping economic policies

– The role of voluntary business associations
  • Provide services to members and increase their competitiveness
  • Serve as an advocacy vehicle to help improve the overall business climate
Conclusions

- Development of the absorptive capacity is key for reconstruction efforts
- Local ownership and inputs in the reconstruction process are crucial for capacity building in post-conflict countries
- The aid flow and sequence should follow the increase of absorptive capacity and the path of sustainable development needs

Successful post-conflict reconstruction: From peace to sustainable development
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