



BUILDING DEMOCRACY AND THE MARKET ECONOMY IN POST-CONFLICT SOCIETIES

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Post-conflict reconstruction

In this presentation, we will discuss the importance and challenges that are brought to reality in many post-conflict societies, especially the post-conflict reconstruction challenges. The main focus will be how to build absorptive capacity that affects not only the national community but also local actors and governments and brings development effects that could benefit the society and citizens of those post-conflict countries.

First, I would like to discuss why post-conflict aid is unique. It is unique because those societies are in a transition to peace by rebuilding a new socioeconomic framework of the society. Additionally, reconstruction is necessary to enable conditions for building democratic institutions, good governance, and market economy. It is unique because it needs time, good policies, and patience. The time horizon based on a recent research is spread through three four-year periods. So the path from peace toward sustainable development is composed of three periods. The first four-year period is related to the onset of peace, and the two subsequent four-year periods are important and necessary to build the capacities of those societies for sustainable economic and social development.

Why is post-conflict aid important?

Why is post-conflict reconstruction and post-conflict aid so important? It is important because it is related to political stability, peace, and humanitarian aspects of the world. It is also important because of its size and volume. Let me bring several indicators. 22 to 25 percent of total lending of the World Bank in 2003 was designated to the post-conflict countries. Seventy percent of IDA grants in 2003 also were directed to the post-conflict countries. It is estimated that for reaching MDGs [Millennium Development Goals] the intervention in post-conflict countries should be increased from \$136 billion in 2006 to \$195 billion in 2015. It is important because of the effects of conflicts on the civilians and the humanitarian aspect. Ninety percent of casualties are civilians. Those societies lose human capital. Those societies also usually remain divided societies. So, the intervention needs a complex approach, and the approach to assistance in post-emergency phase is first related to repair and creation of physical infrastructure. Equally important is to start as early as possible to create an institutional infrastructure, which will support economic growth, income generation, and job creation and better manage the institutional gap that exists in post-conflict societies.



The complexity of sequencing reforms

The other issue is that the reforms – policy reforms – need to be sequenced in a way that will start with the social policies and structural policies and then complete with macro policy reforms. In the emergency phase, it is very important to budget support if it is necessary to support investment in infrastructure. The evidence shows that the aid in production and manufacturing sectors is neglected. Through this phase, we are challenged to build realistic and good objectives and to address the issue of sequencing of reforms and transparency. A related challenge is that the experience shows that in most post-conflict countries, there is a lack of clear definition of objectives and coordination in reaching those objectives. Objectives are not very well related to the exit strategies. Objectives are not very well related to ensuring local ownership and local participation in reconstruction efforts and reform processes. There is a sequencing challenge of: how do we better sequence aid and intervention in recipient countries? The evidence from the research also shows that the donors are coming too early and taper off too soon, and this, as we will show later in this presentation, is in discordance with the absorptive capacity.

Transparency, accountability and absorptive capacity

The third challenge is related to transparency and accountability. Transparency and accountability are necessary, and we in the post-conflict societies face many problems to ensure transparency and accountability because we lack monitoring and evaluation mechanisms and also involvement of feedback information. The main issue that should be discussed in relation to the post-conflict reconstruction is absorptive capacity and its constraints. Why is absorptive capacity so important? It is important because of diminishing returns from the aid infusion. It is estimated that the saturating point in aid recipient countries is somewhere between 15 and 45 percent of GDP. It means that, depending on the absorptive capacity, aid recipient countries will be able to absorb 15 to 45 percent of their GDP as foreign aid. The saturating point and absorptive capacity are important because when the saturating point is reached, the aid recipient countries' marginal benefits from foreign aid become nonexistent or negative.

Constraints to absorptive capacity

Because of that, it is very important to address constraints in building absorptive capacity. There are several constraints in building absorptive capacity: macroeconomic constraints, institutional and policy constraints, technical and managerial constraints, and donor behavior constraints. Macroeconomic constraints are related to the “Dutch Disease.” The Dutch Disease has negative effects on the exchange rate and competitiveness of exports in post-conflict societies. Major economic constraints are related also to the debt sustainability and debt burden of the post-conflict societies. Many post-conflict societies also face inflation problems, high interest rates, and labor market distortions and pressures. This is also related to the population's skills and wages.



Institutional and policy constraints

The institutional and policy constraints are very important. Better institutions and policies can contribute to the capacity of post-conflict societies to produce credible strategies and better policies and programs and transform those programs and aid into positive development that accelerates job creation and income generation and ensures transparency over budget systems and public expenditure frameworks. Institutional and policy constraints are also very important because they are related to the decentralization of resources and the efforts and responsibilities of reconstruction. Good policy and institutional capacity will contribute to better policies, priorities, and the possibilities to hold government accountable. A lack of institutional capacity and proper policies in post-conflict societies is usually associated with the increase in aid dependency and negative incentives for reforms in local conditions. Usually it is also associated with the shift of responsibility from government to international actors.

Country Policy and Institutional Assessment

Are there practices to measure institutional and policy constraint? There is an institution and policy country assessment, the so-called CPIA, or Country Policy and Institutional Assessment score, which is done by the World Bank based on [roughly] 20 policies within macro-structural, social, and governance aspects. Each of those 20 policies is scored from 1 to 5, while governance is from 1 to 6. And you use the average score. The research evidence shows that CPIA score during the first four years of peace onset is 2.5, while by the end of the next four-year period, it is 2.82. The CPIA score by the end of the second four-year period is 3.05. That means that the absorptive capacity of countries is developing parallel to the improving policies and institutional capacities. But aid flow is the inverse of this usually. The practice and research evidence show that aid flow is the inverse of this increase in capacity. This can be illustrated by the Kosovo example. The aid infusion in the first four years was much more evident, and we had in the first four-year period 100 [million] euros of foreign infusion. In the next four-year period, we had only 25 to 30 [million] euros. We see that the problem of sequence in aid in relation to the increase of absorptive capacity is a very important lesson to learn.

Technical and managerial constraints

The other constraints for building absorptive capacities are technical and managerial constraints. This is mostly related to the quality of human capital and the quality of education in many post-conflict societies. The education standards and the quality of education are low, and it's not providing enough human resources, which can accelerate the development of those societies. So, technical assistance is necessary to build human capacity, but the experience shows that the best technical assistance is when you build on what exists in post-conflict societies, especially when you support learning versus training, base training on needs, and provide in-job training. The creation of those human



capacities is very necessary because it is important to create a critical mass of people that can understand the development path and challenges and can hold government accountable on public spending.

Donor behavior constraints

We also have donor behavior constraints. Donor behavior constraints are related to the increase of transaction cost because of fragmentary interventions. Fragmentary interventions bring to our attention that we lack the cooperation of local actors in need assessments. Local actors are not cooperating with donors in setting objectives and benchmarks. We have a large number of small disbursed projects, which are very difficult to coordinate. Thus, governments and post-conflict societies are facing uncertainty about how to predict the volume of aid, and there is a lack of cooperation in *ex post* evaluation. *Ex post* evaluation measures the effectiveness of foreign aid, which will be a very important practice in learning from feedback, and *ex post* evaluation is a way to bring more cooperation and to learn more from both sides: recipient countries and donor countries.

Ways to improve absorptive capacity

What are the ways to improve absorptive capacity? An option to create capacities would be that you build capacity as we discussed before. Then, building capacity is very important to start in the early and immediate phase. The other way to increase capacity is to buy capacity. I think this way is used very extensively by the donor countries, and you can build temporary capacity or bypass government capacity. In a post-conflict situation, in the emergency phase, you should practice probably all three possibilities to increase absorptive capacity. But it is very important that, as times goes by, you focus on the sequencing of building capacities because in building capacities, you can ensure country ownership through the reconstruction process. And participation of the government in the recipient countries matters very much.

Local and non-governmental participation

Local ownership and local input through reform is key for building sustainable democracy and institutions in post-conflict society. In ensuring local ownership, two elements are very important. First, you should increase the capacity of those societies for reform and build state institutions. While increasing domestic capacity for reforms, you should ensure local ownership because local ownership is very important for the quality and dynamics of reform processes. Imposing models, without enough discussion and without enough local ownership will distort the local initiatives for reform and the dynamics of reform will be inadequate. On the issue of state building and institutional building, it is very important that we bring into the arena the media, the business community, civil society, and opinions balancing the power of the government to create a



better business environment, a market economy, and new institutions. We enforce also behavior of the government that will stimulate fair political competition and checks and balances practices.

The role of political parties

Here we cannot ignore the role of political parties in building local institutions. Political parties in post-conflict societies are faced with the problem of how to represent the interest of larger political groups versus closed circles and elites. Political parties also have problems building their capacities and their practices within institutions, so political parties don't dedicate too much attention to increasing the role, competence, and capacities of parliaments in post-conflict societies.

So, the role of political parties is seen to divide the powers of the government, and the government very much depends on the powers of the political parties and not too much related to the parliament. And this is one of the key problems that post-conflict societies are facing in building democratic institutions and enacting reforms. Political parties should support practices to build leadership that is visionary and accountable and has integrity, not only to communicate their visions but also to provide policies, programs, and measures that can be achieved toward building sustainable development conditions. Thus, ensuring local ownership is very important because, as [Douglass] North said, institutions cannot be transferred mechanically, cannot be transferred wholesale.

The role of the private sector

Also, we cannot forget the important role of the private sector and the business community. Private sector is very important because it can contribute to overcoming obstacles to growth and development. Research evidence in many countries shows that unfair competition is the main obstacle to businesses and prevents flourishing ownership and building domestic capacities for income generation and job creation. Unfair competition is mostly originating from the weak rule of law, the presence of corruption, and the limited capacities of the business community to affect policies and to have an impact on improving both institutional capacities and political arrangements.

Here, the role of business associations is very important. Business associations are important because they can provide services to their members so that they increase competitiveness. Also, they can act as lobbying and advocacy vehicles to improve business conditions and business environments. In order to do that, practice shows that voluntary membership and competition among business associations bring forth the interests of the business community in improving policies and institution.



Lessons learned

From what I have presented in this short presentation, three conclusions came up. First, the development of absorptive capacity is key for reconstruction efforts. Second, local ownership and input into the reconstruction processes are key in building absorptive capacity and aid. And the third conclusion is that the aid flow and the aid sequence should follow the increase in absorptive capacity and the needs of sustainable development.

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